The Journal of Social, Political and Economic Studies

Spring, 2000 Vol. 25, No. 1

A Vision of Space
James H. Hughes
Should China be Considered an Adversary of the United States?
Frederic N. Smith
Hot Money and the Emerging Markets: Global Political and Economic Determinants of Portfolio Capital Flows
Shah M. Tarzi
Poverty Trends in a Metropolis
Robert G. Mogull
Economic, Political, and Social Influences on Electric Utility Regulation in the Georgia Public Service Commission
David R. Kamerschen and Jeff Reynolds
Illusions vs. Perversity: "Multiculturalism" and the Prospects for Democracy
Miles D. Wolpin
Book Reviews

Council for Social and Economic Studies

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Journal of Social, Political and Economic Studies is a refereed journal published quarterly by the Council for Social and Economic Studies. Subscriptions, manuscripts for submission to the editorial board, and all correspondence should be addressed to:

The General Editor,
P.O. Box 34070, N.W.
Washington D.C., 20043, U.S.A.

Telephone (202) 371-2700
Fax (202) 371-1523
E-mail SOCECON@AOL.COM

Formerly known as *The Journal of Social and Political Affairs*, the subscription rate is $80.00 per annum for libraries and institutions, $38.50 p.a. for faculty members, students and other private individuals. Reduced three-year subscriptions are available at a cost of $220.00 for libraries and $110.00 for individuals. For mailing addresses outside the USA please add $8.00 per annum. Mastercard/Visa accepted.

The attention of readers is also drawn to the valuable Monograph Series (ISSN 0895-724X) published in association with the Journal and advertised elsewhere in this issue. Members of the academic community and other qualified individuals are invited to consult the General Editor at the above address concerning articles which they may wish to submit for possible publication.

ISSN 0193-5941

Copyright © 2000 by The Council for Social & Economic Studies

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Journal of SOCIAL, POLITICAL AND ECONOMIC STUDIES

Roger Pearson
General Editor
Dwight D. Murphey
Associate Editor

Spring, 2000 Vol. 25, No. 1

CONTENTS

A Vision for Space
James H. Hughes 3
Should China be Considered an Adversary of the United States?
Frederic N. Smith 19
Hot Money and Emerging Markets: Global Political and Economic Determinants of Portfolio Capital Flows
Shah M. Tarzi 27
Poverty Trends in a Metropolis
Robert G. Mogull 51
Economic, Political, and Social Influences on Electric Utility Regulation in the Georgia Public Service Commission
David R. Kamerschen and Jeff Reynolds 61
Illusions vs. Perversity: "Multiculturalism" and the Prospects for Democracy
Miles D. Wolpin 79
Book Reviews: Stocks for the Long Run; Capital Ideas and Market Realities; Luxury and Status - Why Money Fails to Satisfy in an Era of Excess; The American Dream - Can It Survive the 21st Century?; Crimes and Mercies 99

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

EDITORIAL BOARD

General Editor

Roger Pearson
Council for Social and Economic Studies
Washington, D.C.

Associate Editor

Dwight D. Murphey
The Wichita State University

Advisory Committee

James T. Bennett
George Mason University

Stephen R. Bowers
James Madison University

Gary Bullert
University of Seattle

F. McA. Clifford-Vaughan
University of Natal

Sam. S. Crutchfield, Jr.
Washington, D.C.

Daniel Ellegiers
University of Brussels

Robert E. Gilbert
Northeastern University, Boston

Garrett Hardin
U. of California, Santa Barbara

George A. Kourvetaris
Northern Illinois University

Maxwell A. Miller
Mountain Sts. Legal Foundation

Edward M. Miller
University of New Orleans

Robert C. Richardson, III
Washington, D.C.

Alan Ned Sabrosky
Rhodes College, Memphis

Joseph Wayne Smith
University of Adelaide

Robert Schuettinger
Yale University

Oleg Zinam
University of Cincinnati

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

A Vision for Space

James H. Hughes
Englewood, Colorado

New initiatives are needed by the U.S to maintain a strong space program, inclouding the develop of the moon. This program will help the U.S. to build a missile defense system in space.

Key Words: Ballistic missile defense, Brilliant Pebbles, Space Based Laser, space transportation, heavy lift booster, the moon, water on the moon.

Our vision for space has changed since Wernher von Braun led the space program and Apollo moonshot.[1] The growth of computers, development of sophisticated infrared, radar, and optical sensors, and innovative use of satellite networks have created new roles for space, especially in telecommunications. But one essential element is missing: the pioneer with the vision, passion, and understanding to develop space.

On July 20, 1969, Neil Armstrong stepped on the moon's surface. But since then, more than 25 years ago, man has yet to return to the moon. In spite of the discovery of water on the moon,

---

[1] For him [von Braun], the journey to the Moon would not be an end in itself; rather, it would represent but one chapter in the exciting story of man's space-faring adventures. Unmanned satellites, manned satellites, Earth-to-orbit shuttles, voyages to the Moon, voyages to Mars - it was the beginning of man's reach into space, the transition from *Homo terrestris* to *Homo spatialis*. Operations in Earth orbit, such as rendezvous maneuvers, transfer of propellants, assembly of space vehicles, and also spacecraft modifications and repair, particularly rescue operations, should be developed. For von Braun, each space flight project was part of an organism that grew and evolved almost like a living system. "Let's not consider the journey to the Moon as a 'Kilroy was here' affair, "he would say to his co-workers. "This project will be a milestone in man's space flight enterprise. Each future project will directly benefit from it."

The Earth orbit rendezvous mode would provide an ideal opportunity, almost without extra cost, to develop Earth orbit operational capabilities. They would at first serve the Moon landing project, and then, for all the future, they would be available as proven technologies for many other projects, including space station support, refueling of spacecraft, deep space mission staging functions, maintenance of scientific and commercial platforms, repair and rescue operations, and assembly of manned space vehicles for Mars expeditions. Ernst Stuhlinger, Frederick I. Ordway III, Wernher von Braun *Crusader for Space*, Krieger Publishing Company, 1996, p. 173.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

greatly simplifying the development and operation of a manned lunar base, the United States has yet to send a man back to the moon.[2]

We need a vision for space with new horizons, including man in space. A vision for space will help the United States keep ahead of Russia, China, Europe, Japan, and India, who are actively challenging American leadership.[3] A vision for space can lead to a surge of technological and scientific progress, benefiting the U.S. economy and military with long-term improvements in basic technological infrastructure.

A vision for space will develop manned bases on the moon.[4] A vision for space will build various two-stage reusable rocket and Single Stage To Orbit designs to dramatically cut the cost of space launches.[5] The economic and military implications of a Single Stage To Orbit (or two-stage reusable rocket) - lower launch costs - are enormous. It will open wide the door to space.

A vision for space would exploit the technological advantages

---

[2] In January 1994, the SDI spacecraft, dubbed Clementine (after the miner's daughter), was sent hurtling to the Moon. Examining the radar reflections from the Moon's south pole, Nozette's team announced that the results were consistent with ice.
Lunar Prospector was launched in January 1998. By March, the mission's principal investigator, Dr. Alan Binder, was ready to announce results. According to Binder and his team, Lunar Prospector's neutron spectrometer had detected water, in concentrations of about 0.5 percent in both of the Moon's polar regions. Robert Zubrin, *Entering Space*, Penguin Putnam, 1999, pp. 92-93.

[3] Today's competitive international space launch environment was anticipated nearly a decade ago: Martha Cosgriff, "The Russian/Chinese Commercial Space Challenge," *The Journal of Practical Applications in Space*, Spring 1993, Vol. 4 No. 3, pp. 211-222.

[4] Lisa Bell, Curt Bilby, John W. Boyd, George Davis, David Korsmeyer, Hans Mark, Todd McCusker, Brendan O'Connor and Elfego Pinon, Andrew Frizzell, and Harlan J. Smith, "The Human Exploration of the Solar System," 42nd Congress of the International Astronautical Federation, October 5-11, 1991.

Lockheed, among other companies, including RAND, did at least twenty-one separate lunar base studies and proposals between 1961 and 1963. Martin J. Collins and Sylvia K. Kraemer, William E. Burrows, *Space Discovery and Exploration*, Hugh Lauter Levin Associates, Inc. 1993, p. 140.

[5] But these space launch vehicles - the only ones used thus far for space operations - were designed and built with old technology based on obsolete ways of thinking. They were and are nothing more than ammunition.... As space visionary Arthur C. Clarke observed more than a quarter of a century ago, operating expendable space transportation vehicles is equivalent to building the ocean liner H.M.S. Queen Elizabeth, sailing it once across the ocean, and scuttling it upon arrival at its first port of call. The basic economics of such an operation mean it's extremely expensive to book passage or ship cargo on such a one-use vessel. G. Harry Stine, *Halfway to Anywhere*, M. Evans and Company, 1996, p. 17.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

of deploying ballistic missile defenses in space to meet the growing threat of intermediate and long range ballistic missiles. In March 1999, the House and Senate, recognizing the growing threat of long range ballistic missiles, voted overwhelmingly for deploying a national missile defense.[6]

Strategy for Space

There is an essential link between space programs and defense.[7] The German V-2 rocket spawned the American and Russian ballistic missile and space programs. The linkage between space and defense extends to the deployment of ballistic missile defenses in space.

There are inherent advantages to deploying ballistic missile defenses in space: automated operation; continuous, global coverage; higher position compared to ground based defenses or a boosting rocket; long lines of sight especially for high energy lasers; and a boost phase defense capability, which ground-based defenses lack.

A strong space program will deploy ballistic missile defenses in space to control space.[8] A strong space program will also result in spin-offs assisting the deployment of ballistic missile defenses. Improved space launch capabilities such as a heavy lift booster, and faster turnaround at spaceports are key ingredients for a strong space program and the deployment of ballistic missile defenses in space.

A strong space program will require the means to defend itself, lending itself to develop ways to control space, including the destruction of satellites and rocket boosters. The ability to control

---

[6] On March 17, 1999 the Senate voted 97-3 for S. 257 to declare it is the "Policy of the United States to deploy as soon as technologically possible an effective National Missile Defense capable of defending the United States against limited ballistic missile attacks (whether accidental, unauthorized, or deliberate)." One day later, on March 18, 1999, the House of Representatives voted 317-105 for H.R. 4 to declare "That it is the policy of the United States to deploy a national missile defense."

[7] When the V-2 made its first successful test launch on October 3, 1942, the commander of the German rocket facility at Peenemünde Walter Dornberger exclaimed, "Today the spaceship has been born!" Ernst Stuhlinger and Frederick 1. Ordway III, Wernher von Braun, *Crusader for Space*, combined edition, Krieger Publishing Company, 1996, p. 29.

[8] It is this requirement for a total national space effort incorporating an innovative new strategy posture that Project High Frontier has identified as a national necessity. The U.S. should learn this lesson before it is doomed to repeat that earlier pattern of failure. Lt. Gen. Daniel 0. Graham, USA (Ret.), *High Frontier Supplemental Report*, High Frontier, 1983, p. 6.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

space, essential for a strong space program, will also provide means for intercepting long range ballistic missiles.

The current administration, adverse to deploying ballistic missile defenses in space, is also critical of developing the means to control space. John Hamre, an administration spokesman, is emphatic about not developing ways to control space by intercepting rocket boosters or destroying satellites, seeking instead "soft" solutions, relying on the disruption of satellite communication links.[9]

But Hamre's understanding of space will be prove to be inadequate, unable to cope with self-guided rockets or programmed attack satellites. Robotic satellites or manned space vehicles can operate without satellite communication links.[10] There is more to denying an opponent space than disrupting satellite communication links.

We need vision for space. The Air Force's "Doable" Space plan contains no major initiatives. It advocates primarily the exploitation of commercial space, instead of creating new technologies and initiatives.[11]

While NASA administrator Dan Goldin has worked wonders using spin offs from *Brilliant Pebbles* technology in his program for faster, cheaper, better space probes, neither NASA nor the Air Force have built a heavy lift booster, space transportation system, or even manned lunar bases, a very realistic and exciting prospect given the discovery of water on the moon.[12]

---

[9] March 22, 1999 Testimony of John Hamre before the Senate Subcommittee on Strategic Forces, Peterson Air Force Base, Colorado Springs. William B. Scott, "U.S. Adopts 'Tactical' Space Control Policy," *Aviation Week & Space Technology*, March 29, 1999, p. 35.

[10] The Defense Advanced Research Projects Agency has begun and effort aimed at demonstrating in orbit that a satellite can be repaired and refueled by an autonomous, space-based robot.... Robert Wall, "Darpa To Demonstrate New Satellite Concept," *Aviation Week & Space Technology*, December 6, 1999, pp. 30-31.

[11] John T. Correll, "A Roadmap for Space," *AIR FORCE Magazine*, March 1999, pp. 20-25.

[12] The current launch vehicles (Atlas, Titan, Delta) are based on technology that is now thirty years old and should be replaced by more efficient and economical vehicles. New unmanned launch vehicles based on the Shuttle technology using solid rocket boosters and the Shuttle's main engine system should be developed. The solid rocket booster is itself an excellent rocket with sea level thrust of the order of 1.5 M lbs. Several solid rocket boosters strapped together could provide a formidable launch vehicle in terms of payload capacities.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

New initiatives can open wide the door to space. A strong space program can help the U.S. quickly build and deploy ballistic missile defenses in space. A grand strategy would link a strong space program with the deployment of ballistic missile defenses in space.

Space Based Defenses

An effective ballistic missile defense must deploy defenses in space. As early as the late 1950s, researchers realized the importance of using space as a global theater to defeat long range ballistic missiles.[13] Project Argus proposed a space-based defense using high

---

Such a vehicle with three solid rocket boosters could put into low earth orbit a payload weighing something like 100,000 lbs. and perhaps up to 20,000 lbs. into geosynchronous orbit with an appropriate upper stage. An important feature of the solid rocket booster is that they are recoverable which means that the cost advantages inherent in that property could be important. This new generation of launch vehicles would not be "expendable" although it would be unmanned. Hans Mark and Milton Silveira, "Notes on Long Range Planning," *NASA*, August 1981, Appendix 4, p. 239.

The U.S. lacks enough booster rockets to orbit a space-based defense system. To develop a low-cost launch vehicle, the Defense Department organized a joint program with NASA and the Air Force. The result is the Advanced Launch System (ALS), a program exploring designs for a heavy-lift booster rocket capable of lifting into orbit a payload in excess of 100,000 lbs. James A. Abrahamson, *Critical Issues: SDI At The Turning Point: Readying Strategic Defenses for the 1990s and Beyond.*, edited by Kim R. Holmes and Baker Spring, The Heritage Foundation, 1990, p. 64.

The *Air Force Magazine*'s 1999 *Space Almanac*, August 1999, pp. 26- 53, lists the payload launch capacities of the current rocket boosters. A heavy booster for Space Based Lasers will not necessarily need to be as large as the Saturn V. Studies have been done illustrating that a medium size Space Based Laser would weigh around 78,000 pounds, requiring a booster with a launch capability between a Titan IVB and Saturn V.

In addition to payload weight, the payload container of the heavy lift booster should be capable of carrying a payload with a diameter of 8.4 meters or greater to accommodate the main mirror of a Space Based Laser (current plans for Space Based Lasers anticipate a main mirror 8 meters in diameter).

[13] Hans Mark, current director of Research and Engineering at the Pentagon, discusses in his 1992 Theodor von Karman Lecture the importance to Project Argus of global coverage derived from deployment in space:

As early as 1957, there were people who began to look at the missile defense problem from a different viewpoint. One of these was Dr. Nicholas C. Christofilos of the University of California's Lawrence Livermore National Laboratory. Christofilos felt very strongly that some kind of a "global" solution to the problem had to be found. He believed that "point defense" systems that could be evolved from anti-aircraft artillery would not be effective in protecting whole populations from missiles that could be launched from anywhere in the world.... He reasoned that placing enough energetic charged particles into

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

energy particles.[14] BAMBI proposed using interceptors deployed in space to attack ballistic missiles in their boost phase.[15] President Reagan's Strategic Defense Initiative relied heavily on space-based defenses for its basic architecture.[16]

The current administration opposes using space for missile defense. Along with its opposition to using space for defense, the current administration's space program (except for space probes) is based on work developed from the 1970s and 1980s - the Space Shuffle and International Space Station. It is time for new initiatives in space.

We can use space to deploy ballistic missile defenses and undertake new initiatives, especially developing the moon as an economic resource, taking advantage of the discovery of water at the lunar poles. The deployment of ballistic missile defenses in space would be a subset of a broad initiative for space.

Our future lies in space. Former Space Commander Howell Estes III called space an emerging center of gravity equal in importance to the oil of the Persian Gulf, if not more important.[17]

---

trapped orbits in the geomagnetic field would create a radiation field strong enough to damage the guidance and control electronics of nuclear warheads passing through that radiation field.

The idea proposed by Christofilos was deemed important enough to warrant an experiment. Plans were made to detonate three small nuclear devices (in the 2 kiloton yield range) above the atmosphere and then to make measurements of the resulting trapped charged particles.... The whole effort was code named "Project Argus."

As things turned out, however, there was a relatively easy countermeasure that could be employed to defeat energetic charged particles trapped in the geomagnetic field.... Progress in hardening electronics was so rapid that the whole Argus idea was quickly abandoned. Nevertheless, the Argus experiment was important because it was, indeed, the first effort to create a global defense system against ballistic missiles. Hans Mark, "Defense Against Ballistic Missiles," 1992 *Theodore von Karman Lecture*, American Institute for Aeronautics and Astronautics, p. 2.

[14] Op. Cit.

[15] Lt. Gen. Daniel O. Graham, USA (Ret.), *High Frontier Supplemental Report* High Frontier, 1983, p. 9.

[16] James A. Abrahamson, *Critical Issues: SDI At The Turning Point: Readying Strategic Defenses for the 1990s and Beyond*, edited by Kim R. Holmes and Baker Spring, The Heritage Foundation, 1990, pp. 57-75.

[17] "... space is emerging as "an economic center of gravity for our country..." Ofto Kreisher, "The Move into Space," *AIR FORCE Magazine*, April 1999, pp. 75-77 [quoting General Estes]. At other times Estes has used the Persian Gulf analogy of space as an economic center of gravity.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

If the U.S. does not take the lead in space, others will.

Ballistic Missile Defense

Space is the logical location to deploy ballistic missile defenses. From space, a ballistic missile defense looks down on a boosting rocket. A space-based missile defense will also have global coverage. It will be available at all times. Ground-based interceptors take longer to move into position.

Ballistic missile defenses in space can provide a boost phase defense capability with global coverage. High-energy lasers in space would take advantage of the long lines of sight and lack of atmospheric interference in space, and provide a boost phase defense. Space Based Interceptors could also provide a boost phase defense capability, and mid course defense. Other boost phase defenses such as the AirBorne Laser, Raptor Talon, or Navy Theater Wide (Navy Upper Tier) depend on special circumstances, or would be local in coverage.[18]

We need a vision for space that will deploy ballistic missile defenses in space. During the late 1980s and early 1990s, President Reagan's Strategic Defense Initiative developed small, sophisticated Space Based Interceptors capable of detecting and intercepting a ballistic missile in its boost or midcourse phases.

The Strategic Defense Initiative also developed high-energy lasers to where they could be built in a ten-year program, given adequate funding, and streamlined acquisition procedures. While the deployment of Space Based Lasers would require a heavy lift booster, we have long needed a heavy lift booster.[19]

---

[18] The AirBorne Laser (ABL) is to equip a Boeing 747 with a high energy chemical oxygen-iodine laser. It would have a range of several hundred miles. Raptor Talon was a program equipping a UAV (ultra-lightweight aerial vehicle) with a miniature interceptor for theater missile defense. Navy Theater Wide is a program for equipping Aegis cruisers with modified Standard interceptors capable of intercepting ballistic missiles outside the earth's atmosphere. The ABL is for boost phase defense. Raptor Talon was also for boost phase defense. Navy Theater Wide could be used for boost phase defense in only special circumstances.

[19] I have advocated the development of a heavy lift booster since 1981 when I was serving as Deputy Administrator of NASA in the Reagan Administration. What I wanted to do was to use shuttle technology. I am enclosing a copy of a short paper that I co-authored with Dr. Milton A. Silveira in which this suggestion was made. This paper was published in August 1981. I am sorry that nothing has been done about this matter. Hans

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Ballistic Missile Defense Program

To deploy an effective national missile defense, the U.S. needs to:

1. Deploy primarily space-based defenses. Sea-based defenses such as Navy Theater Wide (Navy Upper Tier), and other defenses can supplement space-based defenses.

   Space-based defenses could include Space Based Interceptors like Brilliant Pebbles; high-energy chemical Space Based Lasers; space-based sensors such as SBIRS-High and Low, and other defenses.

   Compared to ground or air-based defense, space-based defenses offer inherent advantages of automated, continuous, and global coverage. Automated operation, using satellites directed by a ground control command, would reduce operational costs by minimizing personnel. Space-based defenses provide coverage continuously, 24 hours a day. In addition, space-based defenses can provide coverage against ballistic missiles launched anywhere on the globe.

   Space-based defenses provide multiple opportunities for intercepting a ballistic missile during its midcourse phase or boost phase. A characteristic of an effective defense is having multiple opportunities for intercepting a ballistic missiles. Space-based defenses have that characteristic. Defensive satellites will cross within range of a missile's trajectory. Finally, space-based defenses can provide a boost phase defense capability. A boost phase defense can intercept a ballistic missile before it releases any decoys, multiple warheads, or clustered submunitions;

2. Fund Space Based Lasers with about $1 billion to test a prototype in space: followed by larger appropriations to build and deploy Space Based Lasers (SBLs) in sufficient number to provide coverage of at least two SBLs over key areas of the globe. A program for a strong SBL defense could cost $25-30

Mark, letter to Congressman Bob Schaffer, March 2, 1999, p. 2.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

billion over a 10-year period;[20]

Space Based Lasers can provide an effective boost phase defense, capable of meeting massed, simultaneous ballistic missile launches better than any other near-term defense. Furthermore, Space Based Lasers can interactively discriminate warheads from decoys and other debris, providing critical target information to other parts of an integrated midcourse ballistic missile defense, supplementing sensors such as SBIRS-Low;

3. Restart the Space Based Interceptors program (Brilliant Pebbles), which the current administration cancelled in 1993. This program may cost about $10-12 billion, using streamlined acquisition procedures. Funding at this level could produce more than a 1,000 Space Based Interceptors, depending on how the U.S. handles 10-year life cycle replacement costs.[21] A crash program could result in deployments in as little as three years;[22]

Before the current administration cancelled Brilliant Pebbles, the Defense Acquisition Board had approved Brilliant Pebbles

---

[20] With streamlined management and full funding, a space-based laser system involving 12 space-based lasers could be built in about 10 years and operated for another ten years for about $15 billion to $18 billion. The Heritage Foundation's Commission on Missile Defense (chaired by Ambassador Henry F. Cooper), Defending America: A Plan to Meet the Urgent Missile Threat, The Heritage Foundation, March 1999, p. 39.

The schedule for a subsequent operational deployment would be determined by the funding profile considered realistic, based on the state of threat evolution at the time. Deployment of twelve operational systems [Space Based Lasers] could be accomplished within 6-10 years after the flight demonstration and would cost approximately $15B (FY95$). Letter to Senator Strom Thurmond, dated March 15, 1995, signed by Vance D. Coffman, President of Space & Strategic Missiles Sector, Lockheed Martin; Timothy W. Hanneman, Executive Vice President, Space & Electronics Group, TRW; and Edward T. Gerry, President, W.J. Schafer Associates, Inc.

The figure of $25-30 billion is instead of $15-18 billion to roughly double,the number of Space Based Lasers to provide a stronger defense.

[21] If the *Brilliant Pebbles* program were reinstated under streamlined management and with full funding, deployment could begin within five years for an investment of $4 billion to $5 billion. The total acquisition cost for deploying and maintaining a constellation of 1,000 space-based interceptors for 10 years after deployment would be between $12 billion and $15 billion. Ibid, p. 39.

[22] Caspar Weinberger & Peter Schweizer, *The Next War*, Regnery Publishing, 1996, pp. 264-265. Weinberger (former Secretary of Defense) uses two years. One year was added for conservatism: the program must be rebuilt.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

for moving into acquisition. Space Based Interceptors such as Brilliant Pebbles can provide multiple opportunities for intercepting a ballistic missile during its boost and midcourse phases. The U.S. has the technology for building Space Based Interceptors.

The U.S. needs a strong and effective defense against long range ballistic missiles. The qualities of global coverage, continuous, automated operation, and a boost phase defense capability, inherent in space-based defenses, require the deployment of ballistic missile defenses in space.

Space Transportation

There is a close connection between the development of a frontier and the development of a transportation system to open that frontier. The opening of North America came with the development of navigation for traveling over broad expanses of ocean. The development of transportation and communication links – postal service, roads, canals, and wagon trails, were instrumental in opening the early American frontier. American economic and territorial expansion grew with the telegraph, railroad, and Panama Canal; and, more recently, the interstate highway system.

Likewise, the development of a space transportation system will open up the frontier of space. A space transportation system will include simplified, low-cost space launch capabilities. It will include building space stations for linking interplanetary space travel with low earth orbit access. It will include developing the moon as a base for interplanetary space flight. It will include developing new rockets for use in space, including ion propulsion and a nuclear rocket.

An investment into a space transportation system will provide long term economic and defense benefits enhancing U.S. control of space. It will open the door to the solar system.

Heavy Lift Booster

While the United States is experiencing a surge of small companies developing rapid, low cost transportation into space, this has come about in spite of its official space program, reflecting a revolution against the current system using ballistic missiles as throw-away rockets.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

In contrast to this surge in developing low cost transportation into space, the United States has lacked a heavy lift booster since Apollo. There have been many excuses for the lack of development of a heavy lift booster. The U.S. has been reluctant to return to the moon, it has been reluctant to launch large defense payloads, it has been reluctant to rapidly build manned space stations.

The development of a heavy lift booster could be done quickly using current technology. It need not cost much, perhaps $1-2 billion.[23] A heavy lift booster would be invaluable for launching:

1. High-energy, chemical Space Based Lasers;
2. Other directed energy weapons, and neutral particle beams;
3. Components for space stations, and manned lunar expeditions;
4. Components for a nuclear rocket.

To restart the space program and deploy ballistic missile defenses in space, the United States would be well advised to build a heavy lift booster. The U.S. should bring to completion two independent designs to ensure the availability and success of a heavy lift booster program.

Along with the development of a heavy lift booster, the United States should build new missile launch range. While steps can be taken to expand and update launch facilities at Cape Canaveral and Vandenberg, the commercial, military, and NASA space launch schedule is already pushing the limits of the existing space launch facilities.The U.S. also needs to build another spaceport.

The Moon

The Moon has been described as a "tank farm.[24] It can become

---

[23] Cost figures for a heavy lift booster can be found in "Summary - Space Based Lasers, Status - Capability, Schedules - Costs," 1995, p. 9. SBL attachments to the March 15, 1995 letter to Senator Strom Thurmond from Vance D. Coffman, President, Space & Strategic Missiles Sector, Lockheed Martin; Edward T. Gerry, President, W. J. Schafer Associates, Inc.; Timothy W. Hanneman, Executive Vice President, Space & Electronics Group, TRW.

[24] The lunar mantle contains all essential elements for the full range of manufacturing and construction on a grand scale, plus so much oxygen that some call the moon "a tank farm in space." Smelters could rely less on costly chemical treatments, because heat alone would remove most impurities from many ores in that environment. Waterless cement, specialty alloys, exotic composites (such as glass/metal mixtures stronger than steel, yet as transparent as crystal), powder metallurgy, cold welding, free-fall casting, and

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

a resource base, a laboratory and manufacturing plant.[25] It is an engine and resource for providing economic inputs to developed economies. With its gravity only 1/6 of the earth's, the moon will be a natural exporter to the developed economies on the earth, or to space stations in Low or Medium Earth Orbit.

The discovery of water on the moon has given a new impetus for its development. The discovery of ice on the moon, at its north and south poles, greatly simplifies its development. Permanent, manned bases can be built on the moon, and the moon can serve as a fueling point for interplanetary spaceflights.[26]

The significance of water on the moon is manifold. It will simplify the provisioning of a manned lunar base. It will enable the manned exploration of the solar system at greatly reduced cost by enabling a lunar base, using solar energy, to break water into hydrogen and oxygen for rockets. It will lead to the mining of other lunar resources, increasing the economic effectiveness of a lunar development program.

The economic development of the moon can serve several purposes. It can start an independent lunar economy. It can develop a transportation base for interplanetary space exploration and development. It can reinforce assets in earth orbit.

In conjunction with the economic development of the moon for refueling, the U.S. can establish active, manned observatories for astronomical and geophysical research. It could develop a lunar mining, processing, and manufacturing economy to promote its role for interplanetary transportation, and other economic uses, including

---

superconductors represent a few among many processes and products that plants in space could facilitate. "Sanitation engineers" could dispatch inconvertible waste on trajectories that collide with the sun or disappear into deep space. John M. Collins, *Military Space Forces*, Pergamon-Brassey's, 1989, p. 43.

[25] Haym Benaroya, "Lunar Industrialization," *The Journal of Practical Applications in Space*, Fall 1994, Vol. 6, No. 1, pp. 85-94.

[26] The entire economics of space-flight would alter drastically if it became possible to refuel on the Moon. This may seem a fantastic assumption, and clearly it would not be practical until a lunar colony, with considerable plant and equipment, had been established. But if spaceflight is to be of any value it will lead exactly to this sort of thing. One of the first aims of such a colony would be, in fact, to search for material which might provide rocket fuel. Arthur C. Clarke, *The Exploration of Space*, Fawcett Premier, 1967 [reprinted, copyright 1951], pp. 81-82.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the mining of Helium-3 for fusion energy.[27]

International Relations

A strong program for space will recognize and encourage the ownership of private property in space. But the U.S. space program suffers from excessive "internationalization," keeping it from using space for defense purposes and opening space to private development. Under the current regime, the development of the moon with private property rights would be considered practically impossible. Yet it will be these private property rights that will create economic incentives for a long-lasting economic boom derived from the development of space.

A program for new initiatives for space will need to defend private property rights in space, including the ownership of interplanetary bodies.[28] If the U.S. is to develop space, there must be ownership and opportunity for developing those assets. Otherwise, an "international" context could eventually lead to countries such as Russia and China taking ownership.

The Race for Space

The U.S. must build a vision for space. It is no secret that Russia has long aspired to dominate the world in space. China's successful unmanned test flight of a manned spacecraft - and the uprated booster to carry it - show the Chinese space program has reached a new level of maturity for the design, integration and fabrication of more advanced space systems for both military and civil applications.

---

[27] The Moon also possesses scarce, but in principle obtainable, supplies of helium-3, an isotope otherwise naturally nonexistent in the inner solar system. Helium-3 offers a number of potentially important advantages as a fuel for thermonuclear fusion reactors, and thus perhaps could provide a future lunar colony with a cash export commodity. Robert Zubrin, *Entering Space*, Penguin Putnam, 1999, p. 80.

David G. Stephenson, "There's Gold in Them Thar' Lunar Highlands!," The Journal of Practical Applications in Space, Winter 1993, Vol. 4, No. 2, pp. 137143. David G. Stephenson, "Lunar Manufacture of Helium Three," The Journal of Practical Applications in Space, Summer 1992, Vol. 3, No. 4, pp. 87-99.

[28] The 1967 Treaty on Outer Space states that "The exploration and use of outer space, including the moon and other celestial bodies, shall be carried out for the benefit and in the interests of all countries . . . " The treaty does not affirm private property rights in space and on celestial bodies.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The 7,200-kg. (16,000-lb.) Shenzhou vehicle was launched late on Nov. 20 from the Jiuquan launch site in the Gobi desert in northeast China on board a Long March 2F booster with 1.3 million lb. of thrust. Overall mass of the launch vehicle and payload was about 450,000 kg. (1 million lb.).... The vehicle is a modified version of the Russian Soyuz developed by the Soviet Union more than 30 years ago.

It is also important for internal Chinese leadership reasons - especially between the civilian and military political sectors. Some of that prestige value is "already being tested" by the Chinese military, said Marcia S. Smith, a respected space policy analyst for the U.S. Congressional Research Service.

"It's more than just a project to make them 'feel good' - some in China view it as a step in the evolution of Chinese military capability," Smith said.

The Chinese government-controlled China Business Times also raised the military issue saying the rocket thruster and control technologies developed in Project 921 could help Chinese ballistic missile warheads avoid interception by any U.S. missile defense system ... Chinese industry built the spacecraft and booster, but Russia provided extensive technical help under a largely secret Chinese/Russian manned flight technology agreement administered in part by the Russian Space Agency and Energy.... China's People's Liberation Army played a major role ...[29]

China also is developing anti-satellite weapons. In a July 1998 report to Congress on the military modernization in China, the Department of Defense wrote that Beijing is acquiring foreign technologies that could be used to develop ASAT systems. The report refers to frequency jammer, radar satellite trackers and high-energy lasers, and notes that China already may possess the ability to damage optical sensors on satellites. More recent reports say that China also is working on a microwave warhead to produce a burst of EMP energy to disable a satellite's electronics, and that China last

[29] Craig Covault, "Manned Program Advances Chinese Space Technology," *Aviation Week& Space Technology*, November 29, 1999, pp. 28-30.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

September conducted a laser test against a satellite's sensors.[30]

Clearly, the U.S. must pursue an aggressive space program if it is to win this race, including the deployment of a ballistic missile defense in space.[31]

[30] Data emerging from China indicates the orbital module left in space on Nov. 21 [1999] from China's unmanned test of manned spacecraft remained operational after the descent module returned to Earth (AW & ST Nov. 29, p. 28).... illustrates China's multibillion-dollar commitment to new space facilities and technology.... Craig Covault, "Chinese Facilities Show Major Space Buildup," Aviation Week & Space Technology, December 6, 1999, p. 38.

[31] For arguments explaining the urgent need for this see, James Hackett, "No Space Weapons Vacuum," *The Shield*, July/August 1999, p. 7.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

CROSS CULTURAL COMMUNICATION

By Nicholas Dima Ph.D.

Although instant international communication and rapid travel is now common, a substantial variety of diverse customs and concepts still survive, and with these treasures unfortunately come cultural barriers to sympathetic understanding. Effective *cross cultural communication* is a necessity in the contemporary world if mankind is to avoid unnecessary conflict and preserve peaceful relations between nations while yet retaining cultural diversity.

"This is absorbing and essential reading for those who MUST COMMUNICATE across cultural and geographic frontiers. It is rich in anecdotes and insight."

RICHARD W. CARLSON
Director, Voice of America

"The dynamics of global change make new demands on those who serve the United States armed forces abroad. This book by Nicholas Dima will be of great value to military personnel preparing for an international assignment."

RICHARD V. ALLEN
Former National Advisor to President Reagan

ISBN 0-941694-36-4
Price: $15.00
128 pages, Paperback 7" x 10"

Institute for the Study of Man
1133 13th St., N.W., Suite C-2, Washington, D.C. 20005-4298
Tel: (202) 371-2700 Fax: (202) 371-1523

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Should China be Considered an Adversary of the United States?

Frederic N. Smith
Washington, D.C.

There is much to suggest that China's posture toward the United States is essentially that of an adversary. The author examines relations with China since 1949 and the various ideas behind the view that "business as usual" is called for with China, and finds that the assumption of normalcy is misplaced.

Key Words: China, Chinese foreign policy, United States foreign policy, the Far East, U.S. military strategy, U.S. trade strategy, China's threat to Taiwan.

Today's news is reminiscent of the 1930s when the aggressions of Imperial Japan occupied a prominent place in the news. History does not repeat itself exactly, but there are many similarities. China needs oil for industries as did Japan at that time. America was inundated with Japanese trinkets and toys in the 1930s and now it is flooded with Chinese-made products of every kind. China is badly overpopulated and its efforts to limit each family to one baby have largely failed. Japan in the 1930s was described as being greatly overpopulated and badly in need of oil and raw materials. As Japan invaded Manchuria and later China proper, the United States protested her actions, but it was not until Pearl Harbor was bombed that the United States adopted a tough policy.

One major difference between the 1930s and the present is the blatant way the PRC was able to buy its way into the upper circles of the Democratic Party by way of illegal election contributions. The PRC parlayed these contributions into all sorts of White House connections. Visiting Chinese Generals were photographed with President Clinton and were able to spend time with him in the oval office. Such things are unprecedented. The usual protocol in Washington is that defense visitors pay a call on their opposite number in the Pentagon or field. Thus, the Commandant of the PRC Marines would be received by the U.S. Marine Corps Commandant. The visiting Chinese General officers not only got to see President Clinton but were shown American military installations and how they

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

operated on a scale that was not reciprocated when American defense visitors journeyed to the PRC. Serious security questions have arisen over these visits.[1]

China is now fueling her expanding economy by means of her large imbalance of trade with the United States. However, she is running out of domestic oil, and claims large areas in the South China Seas thought to contain large deposits of oil and gas. In 1966 China was the third largest oil consumer in the world.[2] In nearly every instance, Chinese claims for these areas in the South China Seas are disputed by one or more Asian nations, thus setting the stage for possible military flare-ups in that part of the world. This is particularly true in regard to the Spratley Islands, which are also claimed by Vietnam, Malaysia, Taiwan, the Philippines, and Brunei.

The huge inflow of dollars from her trade surplus with the United States is assisting the PRC in modernizing her Armed Forces. Principally, she buys modern weapons from Russia and to a lesser extent from Israel and from other nations willing to sell to her. Who is China getting ready to fight? There are really only two answers. First, she needs more modern forces to invade Taiwan, since Taiwan appears to be less than enthusiastic about becoming part of China. Second, she is getting ready to fight the United States, since the U.S. is the only country that stands in her way of complete domination of Asia. Of course, Western and American optimism is built on the hope that further expansion of capitalism in China will result in a complete disappearance of Communism. Others state that China is so technologically backward that she will never risk war with the United States. Any veteran of the Korean War recalls that China was very backward in 1951 when her troops marched across the Yalu River and threw the American forces backward to the 38th parallel and a little beyond. Americans are prone to forget that China is a nation willing to take a million casualties or even have a few of her cities incinerated by nuclear weapons if that is what it takes to get the United States out of Asia. As regards technology, China regularly keeps at least 50,000 graduate students and scholars in the United

---

[1]See Bill Gertz in *The Washington Times* for February 19, 1999, pgs. 1, 14.

[2] "Maritime Security Between the U.S. and China," by LCDR Wayne R. Hugar USN, *Naval Intelligence Professionals*, Fall 1998, p.2.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

States and Canada, whose main function it is to gather and absorb American technology. Of course, not every student is a spy and many do not cooperate, but the Chinese government can cancel their studies here and return them to China if they do not do the bidding of the Chinese government.[3]

Another common argument is that China is more interested in trade than in fighting. The record says otherwise. The Chinese Communists gained power in 1949 after defeating the Nationalist forces. She then attacked and overwhelmed Tibet in 1950. She entered the Korean War in 1951 and fought until the truce was declared in the summer of 1953. China invaded the Indian northern frontier in 1962. She furnished substantial assistance to North Vietnam during her war with the United States and then invaded North Vietnam in 1979 in an effort to seize some disputed land. In addition to these conflicts, China shelled and harassed the islands of Quemoy and Matsu in the late '50s and early '60s, and had several small military encounters with other Asian nations over the Spratley Islands. And of course, most recently the PRC fired missiles into the main shipping lanes outside of Chilung and Kaohsung on Taiwan to intimidate her, which caused the United States to deploy two aircraft carrier task forces in response.

The problem is that the United States is an ally of Taiwan. How close an ally might bring a different answer from President Clinton and Secretary of Defense Cohen. The old Chinese Nationalists do not run Taiwan anymore. The native Formosans like their life just as it is and are not anxious to become part of China again.

A plausible judgment is that the PRC represents a threat against the United States, but there are those who ask what kind of threat? China does not now have an army, navy or air force equipped to operate very far from her own shores, but the PRC does have ICBMs pointed at the United States and is going to build nuclear ballistic missile submarines in order to threaten the United States from her own shores. At the present time, the U.S. still has more and better submarines, but the Chinese have already asked Americans if they are

[3] See *Chinese Intelligence Operations* by Nicholas Eftimiades, Newcomb Publishers, Inc. (Arlington, Virginia) 1998, p. 134.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

willing to have Los Angeles incinerated.[4] In 10-15 years, China could have enough modern weapons to challenge the United States, particularly if she uses a first strike. China is also deploying 650 short-range missiles opposite Taiwan in order to be able to obliterate the island if she has to.[5]

However, the United States does have some cards to play in Asia, particularly if it can retain its friends in Asia. Above all, it would be very serious if the alliance with Japan were ruptured for any reason. American agreements and bases in Japan give U.S. armed forces a great deal of flexibility in the Asian theater. The United States is also on good terms with Malaysia, Singapore, the Philippines and Australia on most regional issues. Thailand, which was a stout partner during the Vietnam War, has almost been bullied into neutrality by the PRC. Burma has been somewhat compromised by the PRC, and is reported to be growing restive. Pakistan, who is dependent for her missile and nuclear assistance from the PRC, is not the friend she once was to the United States. India must be rethinking all her positions. She is now a new nuclear power and is uneasy about PRC penetration in Burma and Pakistan, as well as of the Indian Ocean. American ability to field anti-missile equipment to protect allies could play a large role in U.S. strategy in Asia in the years ahead.

This article only purports to discuss the Chinaese threat, but in a related context it seems logical to mention North Korea. In that connection, the Soviet Union just re-established close ties with North Korea. The United States, as everyone knows, has tailored its armed forces to fight two wars simultaneously. What if China attacked Taiwan and at the same time North Korea marched south in one last fling at taking South Korea? This would certainly complicate the picture and present the United States with two wars to fight in Asia. Such a situation would require a full-scale mobilization of the nation, such as was done after Pearl Harbor. No one is really prepared for that.

---

[4]See news item entitled: "Poet general" in *The Washington Times* for January 28, 2000, p. A8 for remark by Chinese General.

[5] *The Washington Times*, October 8, 1999, p. A9, Bill Gertz and Rowan Scarbrough "Inside the Ring."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

However, regardless of the evidence, people of good will argue that more trade is what is needed. They say that more trade reduces the likelihood of war. History, however, does not bear them out. The United States has fought two major wars with Germany and two with England, both of whom were major trading partners. It would be comforting to share the optimism that more trade will mean more democracy and that Communism and authoritarianism will vanish from China. The veterans of the "Long March" to Yenan in 1934 by the Communist Army of China are nearly all gone now. However, their sons occupy places high in the PRC government and their grandsons run the industries of China, particularly the plants providing military items. They are not going to give up easily. They still want revenge for the million casualties inflicted upon them in the Korean War. It is likely that only two things will bring about substantial change in China: a major revolt of the people or a tremendous crash of the economy - either one or both. Nothing else will change the course of China at present. China does worry, for instance, about its 200 million jobless people who roam China.[6]

Again, back to trade. As time goes by, the United States' balance of trade with China gets worse and worse. There is not free trade with China. American companies are competing with both slave and forced labor. Even American merchant ships can make only one stop at a Chinese port. In other words, they can unload cargo in Shanghai, but cannot go to Tsingtao and load cargo for the United States. The United States does not nearly have access to all of China's markets. In that connection, it is interesting to note that real buildup in modernization of the PRC military, started in 1990 at the end of the Bush administration and accelerated during the Clinton administration.[7]

China is getting herself well-positioned. Chinese-owned companies are located at either end of the Panama Canal; and China almost secured the harbor at Long Beach, California. Just think how many "special forces" the Chinese could put in place by using one or two Chinese ships carrying the large containers that smugglers use.

---

[6] Orville Schell, Ed. *The China Reader*, (Vintage Books, NY, NY: 1999), p. 362.

[7] Edward Timperlake and William C. Triplett, II, *Red Dragon Rising*, (Regency Publishing, Inc., Washington, D.C., 1999), p. 46.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Think how much damage a couple of small nuclear bombs could do at either end of the Panama Canal as far as preventing the United States from reinforcing its Pacific Fleet is concerned. Panama itself will be lucky not to become a miniature narco state, let alone be able to look after the security of its own territory.

What can be done now? As a beginning, the United States could limit the number of Chinese students to the same number of Americans who are allowed to study in China. It could insist that the Chinese take steps to balance its trade with them or face stiff tariffs. It could also insist that military exchanges be done on an equal basis and that Americans be allowed to see Chinese bases and units in action and not be taken to hear some dull political lecture in a hall in Beijing. It should also insist that the Chinese Navy cease playing "chicken" with American ships that visit Hong Kong.[8] It can also insist that they reduce their espionage by 80% or have nearly all their people sent home. Never again should someone like John Huang be hired as a consultant to an American government department and given a top secret clearance, which no consultant prior to him had ever received.[9]

Meanwhile, the PRC goes ahead with its military buildup. Construction of China's first aircraft carriers is scheduled to start in 2001 in Shanghai. The Shanghai Jiangnan Shipbuilding Company is scheduled to build three aircraft carriers simultaneously. These carriers are expected to have mostly Russian equipment, including Su 33 aircraft, also known as the Su 27K. To counter American aircraft carriers, China is buying two Sovremmeniy Class destroyers from the Russians, carrying the SS-N-Sunburn sea-skimming missiles capable of sinking a carrier or cruiser. The first Sovremmeniy is already en route to China. Russia has reportedly also offered China two Akula Class nuclear submarines, which carry land-attack cruise missiles. These submarines could also be used to attack U.S. carrier groups. Russia has also sold China four Kilo Class diesel submarines. This type of submarine is particularly suited for operating in Chinese waters. China prefers to buy weapons, because espionage and reverse

---

[8] U.S. Naval Institute *Proceedings*, September 1948, p. 78.

[9] "China Commits to Carrier Construction With Daunting Aircraft," *Navy News & Underseas Technology*, August 23, 1999, p. 1.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

engineering are not yielding timely results.

Current pundits on China are today saying that now that the accidental bombing of the Chinese Embassy in Belgrade is in the past, the United States can get on with trade and cuddling. Very few Americans or anyone else are aware that the Chinese machine-gunned the American living quarters in Beijing three days after the Tiananmen massacre because Western diplomats, and particularly attaches, were keeping a close track on which Chinese military units participated in the slaughter. They only stopped shooting at the quarters after American Ambassador Lilley told them the United States would break off relations if any Americans were harmed.[10]

A reader may be inclined to say that the facts just recited are just indicators and may not really be that important. However, Chinese Defense Minister Chi Haotian made the following statement as recently as December 1999:

> Seen from the changes in the world situation and the United States' hegemonic strategy for creating monopolarity, war is inevitable. We cannot avoid it. The issue is that the Chinese Armed Forces must control the initiative in this war ... We must be prepared to fight for one year, two years, three years, or even longer.[11]

China is not now equipped to go to war with the United States, but in light of her recent statement on February 21, 2000, about attacking Taiwan if the latter does not negotiate reunification, she may decide to attack Taiwan on the assumption that the United States will stay out of the fight. This means that the possibilities regarding China are immediate and significant.

Frederic N. Smith served twenty years with the U.S. Navy, including two tours in Korean waters during the Korean War. He subsequently worked nineteen years on Capitol Hill and six years for the Selective Service Administration. He holds a Doctorate in Russian Studies from Georgetown University.

---

[10] Timperlake and Triplett, *Red Dragon Rising*, p. 37.

[11] As reported in *The Washington Times*, January 12, 2000, p. A16.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Future of the Gulf

Dr. Gawdat Bahgat
Indiana University of Pennsylvania

CONTENTS

List of Tables : Acronyms : Introduction
Chapter I The Future of the Gulf Monarchies
Economic systems
Political regimes
The succession question
Military security
Conclusion
Chapter II The Future of Iraq
Domestic settings
Regional players
Shia'as
Kurds
Water resources
Oil policy
Security
International scene
Future of Iraq: Concluding remarks
Two less-likely scenarios
Two more-likely scenarios
Chapter III The Future of Iran
Domestic environment
Economic structure
Political system
Regional Settings
International scene
Conclusion : Bibliography

ISBN 0-930690-55-9 • Paperback, 106 pages
With Charts, Diagrams and Tables : Price $18.00
VISA AND MASTERCARD ACCEPTED

Journal of Social, Political and Economic Studies No. 26
1133 13th St. NW, Suite C-2, Washington DC 20005
Tel: (202) 371-2700 • Fax: (202) 371-1523

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Hot Money and the Emerging Markets: Global Political and Economic Determinants of Portfolio Capital Flows

Shah M. Tarzi
Bradley University

At the international level the scale and composition of so-called 'hot money' or portfolio equity capital inflows to emerging markets is a function of the globalization of international capital markets, and the securitization of these markets. Countries with a fast rate of economic growth and where governments are committed to privatization, liberalization of domestic markets, and the development of domestic stock markets, are more likely to attract foreign portfolio equity investments.

Key Words: Global Finance, Emerging Markets, International Stock Markets, International Political Economy

I. Introduction

Foreign portfolio equity investments (FPEI) are capital flows that enable foreign investors and global financial market participants to purchase securities (stocks and bonds) in the equity markets of foreign countries. FPEI flows are a recent phenomenon dating back to the early 1990s, and have generally grown over this decade. FPEI flows trebled in 1993 compared to a year earlier. However, there was a short-term decline in FPEI flow growth in emerging markets in 1995, primarily in FPEI to Latin America in response to the Mexican financial crisis of December 1994. Investment flows resumed a few months later and by 1996 the volume of new equity raised on international capital markets by countries with emerging markets increased by 34 percent, or $15 billion, over 1995.[1] This large increase illustrates the resilience of the emerging markets as an attractive destination for portfolio investments. The dramatic rise in the value of the stock markets of the emerging economies attests to

[1] World Investment Report 1997, *Transitional Corporations, Market Structure and Competition Policy* (New York, NY: United Nations Publications, 1997), pp. 112-113; International Monetary Fund, *International Capital Markets: Developments, Prospects, and Key Policy Issues* (Washington DC: IMF Publications,1997), pp. 244-245.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the interest of global investors in the emerging economies of Asia and Latin America. Between 1986 and 1995, stock market capitalization in emerging countries grew at a much faster rate than market growth in the developed countries. The emerging countries' stock markets grew more than ten-fold, from $171 billion to 1.9 trillion. At the same time, the market share held by emerging countries in the world stock market capitalization increased from 4 percent to 11 percent. Asia and Latin America were the primary destination for investments. Between 1992 and 1993, investment flows to Asia increased by 560 percent and to Latin America by 230 percent. FPEI flows rose sharply to both regions in 1996.

The objective of this article is to discern and critically examine the global determinants of the explosive growth of the foreign portfolio equity investments in emerging markets. This paper will identify and examine the so-called 'push' factors in the international financial, economic and public policy environment, stimulating large-scale capital flows to emerging markets in the 1990s.[2] This framework can be characterized as the 'international system' level. The push factors encompass structural and cyclical developments at the level of the international financial markets that stimulate capital flows to emerging markets. They facilitate access to global portfolio capital as an external source of financing for newly industrializing economies of Asia and Latin America.

The sheer size and potential of portfolio equity as a source of external financing for emerging market enterprises make this subject extremely important. As of 1997, institutional investors managed $20 trillion in assets, only a small portion of which was invested in

---

[2] Several studies have examined some of the causes of capital flows, emphasizing pull factors. See, for example, Guillermo Calvo, "Inflow of Capital to Developing Countries in the 1990s," *Journal of Economic Perspectives,* Vol. 10 (Spring), pp. 123-39; Eduardo Fernando-Arias, 1996, "The New Wave of Private Capital Flows: Push or Pull?" *Journal of Development Economics*, Vol. 48 (March), pp. 389-418; World Bank, *Private Capital Flows to Developing Countries: The Road to Financial Integration* (New York: Oxford University Press, 1996). For a recent theoretical analysis of pull factors see, Pierre-Richard Ageor, "The Surge in Capital Flows: Analysis of "Pull" and Push", *International Journal of Finance and Economics,* forthcoming; Peter Garber, "Managing Risks to Financial Markets from Volatile Capital Flows; The Role of Prudential Regulation," *International Journal of Finance and Economics*, Vol. 1 (July), pp. 183-95; Ilan Goldfajn and Rodrigo O. Valdes, 1997, "Capital Flows and the Twin Crises; The Role of Liquidity," *IMF Working Paper 97/98* (Washington; International Monetary Fund, 1998.)

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

emerging markets. Just one percent reallocation of these managed assets toward the emerging market economies would constitute a capital flow of $200 billion, an amount vastly exceeding other forms of capital flows such as commercial bank lending, official government or international organization flows (IMF, World Bank), and foreign direct investment. More importantly, portfolio investments are highly yield-sensitive, more volatile, and of shorter duration compared to other forms of capital flows. These flow characteristics allow FPEI to be easily reversed in a very short time, and such changes can result in severe negative impacts on macroeconomic stability and growth. These impacts were demonstrated with the ongoing Asian financial reversal that started in late 1997. Further, FPEI can improve welfare in the host country by enabling households to achieve higher levels of consumption. Economic growth is also enhanced when local enterprises are able to raise the necessary capital on local stock markets for expansion and growth. However, potentially undesirable effects also can occur, such as rapid monetary expansion, inflationary pressure, and the appreciation of exchange rates, etc. More importantly, inherent problems exist when exposing local financial markets to the risk of sudden FPEI withdrawals. In this regard, understanding the international determinants of FPEI flows will allow preliminary assessment of whether and to what extent these flows are sustainable.

This study will address a number of specific issues regarding FPEI growth and sustainability. These issues address the role of development, global diversification, market transaction liberalization, institutional investment, and interest rate fluctuations on FPEI flow. We will evaluate the impact of financial and macroeconomic developments in the developed economies upon the magnitude of FPEI flows to emerging markets. This paper will assess the extent that recent globalization of the international capital markets has permitted greater diversification, enabling portfolio investors to diversify holding across countries and regions of the emerging markets. More specifically, we will evaluate whether and to what extent the scale and composition of the capital flows to emerging markets in the 1990s have been affected by changes in the international financial markets such as the growing liberalization of the financial markets and capital account transactions of developed economies, the growing role of institutional investors as purchasers

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

of emerging market securities, and securitization.

Further, this paper will consider the impact of changes in international interest rates on flows to emerging markets. For example, we will consider the question of whether declining long-term interest rates in the developed economies, especially the United States, are responsible for the decision of fund managers to seek higher-yielding emerging market financial assets.

Policy makers in emerging market countries host to FPEI have been concerned about the perceived volatility of these flows, the potential threat of sudden withdrawal, and the consequent negative impact on domestic economies. As the questions posed in this study are addressed, we can discern some important implications for the public policy of national governments, and address some of the concerns for the negative impacts.

Our study involves the following two general hypotheses:

Hypothesis One: A strong inverse relationship appears to exist between long-term interest rates in the major industrialized countries and FPEI flows to emerging markets. Specifically, we suggest that the expansionary monetary policy in the OECD countries in the early 1990s and decline in interest rates in Japan and the United States prompted fund managers to seek higher yields through investments in the emerging market securities. As a result, the stage was set for FPEI in emerging markets.

Hypothesis Two: The scale and composition of FPEI flows to emerging markets in the 1990s have partly been a function of international finance structural changes, namely the globalization of international capital markets, the liberalization of financial markets and capital account transactions in mature market economies, the growing role of institutional investors, the development of investment vehicles facilitating flows, and securitization in the global financial markets.

Host government policies play a critical role in attracting FPEI. The emerging market countries' host governments' pursuit of financial liberalization and privatization and macroeconomic stabilization affect FPEI flow. Countries that have registered fast economic growth and have dynamic securities markets offer a broad base for investment in the primary emerging-markets destination for

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

FPEI. Clearly these economic and financial attributes in the host country are important factors that serve to "pull" FPEI to a particular emerging economy or emerging market region. This study, however, will focus primarily on the international 'push' factors referenced earlier, as those conditions in the host country that 'pull' FPEI have been addressed in detail elsewhere in the literature.2 Nevertheless, a brief discussion of 'pull' factors is warranted in order to draw a clear distinction between the international level factors and those at the level of the host country.

II. Role of Government Policy and Economic 'Pull' Factors in the Host Country

Improvements in macroeconomic performance in the host economies have had a positive impact on attracting FPEI inflows. This improvement is defined as fast economic growth, privatization and the switch to a strategy of market liberalization in the host country. Developing countries that have been able to generate fast economic growth through national government have orchestrated extensive privatization programs and have established active stock markets. Those countries where government authorities have engineered a switch to a strategy of opening their economies to international trade and capital flows have been more successful in attracting FPEI than those developing countries that have not undertaken significant market-friendly macroeconomic stabilization and fiscal consolidation programs.

Throughout the 1970s and early 1980s, major countries in Asia and Latin America – notably South Korea, Indonesia, Brazil, Argentina, Mexico, and India – remained wedded to inward looking, import-substitution models of development. By the late 1980s, these countries in Asia and Latin America adopted structural economic reforms centered on macroeconomic stabilization and liberalization of the financial and trade sectors, and the accumulation of foreign exchange reserves.

These reforms were caused partly as a response to public policy postures encouraged by the IMF, World Bank, and United States government, and were partly motivated by the host government's desire to attract foreign capital and build up a 'buffer' against a sudden reversal of FPEI capital flows. The economic stabilization programs were based on fiscal balance and tight monetary policy, and

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the financial liberalization programs entailed loosening of capital controls and the privatization of public enterprises and services. The new policy environment promised to increase economic growth, reduce uncertainty, and expand opportunities for profitable investment. This environment, in turn, created the need to tap the international capital markets for capital.[3]

The shift to a public policy posture of opening national economies to international capital flows and trade was best reflected in the decision of national governments in major Asian and Latin American countries, including those mentioned earlier, to loosen a variety of restrictions on capital flows. Specifically, the following types of restrictions were either phased out or drastically reduced: capital account restrictions, bilateral payments with IMF members, advance import deposits, import surcharges, current account restriction, surrender of export proceeds, restrictions to purchasing stocks in local companies, and provisions regarding repatriation of income.[4]

In addition to the critical role of portfolio investment-friendly policies of the national governments, the economy in the host emerging-market countries plays a vital role in the regional distribution of private capital flows (or the final destination of FPEI). Indeed, the ability and decision of institutional investors to discriminate among countries as targets for portfolio investment has been in part a function of the quality of economic policy and economic performance in the host country. Capital flows surged again in the mid-1990s, reflecting clear recognition by foreign investors, institutional investors in particular, that fast-growing economies in Asia and Latin America and the development of the stock markets in selected countries presented opportunities for capital gains for the emerging economies' publicly-traded enterprises.

Investors increasingly came to recognize vastly improved economies in most emerging markets in the 1990s, as compared to

---

[3] Hew Pill, "Portfolio Capital Flows to Emerging Markets" *Harvard Business School Case Study*, No. 9-796-129 (August 1997), pp. 2 –7.

[4] See Mark Hallerberg, and William R. Clark, "How Should Political Scientists Measure Capital Mobility?", paper presented at the annual meeting of the American Political Science Association, Washington, D.C., 1997. See also, G. Garrett, and Peter Lange, "Political Responses to Interdependence: What's 'Left' for the Left?", *International Organization*, Vol. 45 (1995), pp. 549- 64.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the 1970s and the 1980s. Many developing countries in these earlier decades relied on import substitution as an important component of development strategy, thereby using capital inflows both to finance large fiscal imbalances and to offset the effects of capital flight. Import substitution was particularly used by emerging-market nations in this earlier period. The resulting fiscal imbalances often contributed to rapid inflation and to a highly overvalued exchange rate. In contrast, the 1990s brought an economic growth strategy to many emerging markets that emphasized opening their economies to international trade and capital transactions, fiscal consolidation, inflation stabilization, and extensive structural reforms designed to improve overall efficiency of the countries' economies. Moreover, these changes took place against a background of a stable macroeconomic environment in the mature markets.[5]

A combination of positive changes in macroeconomic performance occurred in the 1990s, making these newly industrializing economies highly attractive for portfolio investors. Notable macroeconomic performance indicators propelling FPEI were: declining fiscal deficits and inflation; a surge in exports, causing a decline in the ratio of external debt to exports; and dramatic improvement in the real rate of output growth and the corresponding decline in the ratio of external debt to GDP. Emerging market countries saddled with a debt-servicing problem saw their fiscal debts fall from an average of 6 percent of GDP in 1983 to 3 percent of GDP in 1990-1996. The rate of inflation dropped from 177 percent annually in 1979-89 to 19 percent in 1996. During that same period, economic output for this group of countries with debt-servicing problems rose from 2.2 percent a year in the period 1979-89 to over 6 percent in the period 1990-1996. Further, exports nearly doubled during this period, and led to a major decline in the ratio of exports to debt service. As a result, Standard and Poors and Moody, two premier credit-rating agencies, upgraded the rating of these countries. These economic growth and performance characteristics did not go unnoticed by portfolio equity managers and investors, who pay close attention to economic growth, macro-economic stability, and the

[5] International Monetary Fund, *International Capital Markets: Developments, Prospects, and Key Policy Issues.* p.27

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

economic rating of countries.[6]

In addition to the vital role that public policy posture plays in encouraging FPEI inflows through economic stability and economic performance, the host country also must support a stock market sufficiently developed to meet the minimum needs and standards of FPEI investors, institutional investors in particular. Equity portfolio investors are interested in high risk-adjusted returns on their equity investments. The degree of market liquidity is another vital factor that shapes decisions to invest in emerging markets. Market liquidity can be measured by several factors, including an adequate market infrastructure for trading securities, the availability of an exit mechanism through stock exchanges to withdraw capital when necessary, and a relatively broad base of investment options so that the selection of available investment choices are not severely limited.[7]

The importance of the existence of a stock market helps explain why FPEI flows have been heavily skewed toward a small number of major emerging-market countries that have had established stock exchanges with the largest market capitalization, market liquidity, and a level of government regulation regarding information-disclosure and accounting standards. The major emerging markets with these economic and financial market characteristics are South Korea, Taiwan, Hong Kong (province of China), Singapore, Mexico, Brazil, South Africa, Turkey and India.[8]

While these factors help explain why some countries do better in attracting FPEI than others, ultimately we need to discern those important international developments that have created an integrated global market, enforcing the process of globalization, and continue to push portfolio investors outside of national borders for investment opportunities. This paper will critically examine the role of these 'push' forces and comment on their implications for national public policy.

---

[6] Ibid. p. 243.

[7] Michael G. Papaioannou and George Tsetsekos, *Emerging Markets' Portfolios Diversification and Hedging Strategies* (Chicago, IL: Irwin Professional Publishing, 1997), ch. 1

[8] Ibid.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

III. The 'International Interest Rates' Hypothesis and FPEI Inflows to Emerging Markets

The fluctuation of international interest rates has been regarded as an important cyclical international economic 'push' factor behind foreign portfolio capital flows to emerging markets, and in particular behind FPEI flows to these countries. According to the prevailing hypothesis, an inverse relationship exists between long-term interest rates in industrializing economies and capital flows to and equity prices in the developing-country markets. According to this view, world interest rates experienced a sustained decline in the early 1990s, as American interest rates began to decline, and reached the lowest level in 1992 since the early 1960s. Between 1990 and 1996, the average annual rate of inflation for developed countries fell from over 4 percent to 2 percent. The nominal short- and long-term interest rates fell as a result. Short-term rates declined from an average of 7.3 percent in 1987-90 to 4.3 percent in 1994-1996, and long-term rates fell from 8 percent to 6.3 percent during those same periods. These declines in nominal interest rates in industrial countries, it is argued, provided significant impetus to FPEI flowing to emerging markets.[9]

Available evidence provides preliminary support for this proposition. In the face of lower interest rates in the developed economies, the high interest yield and improving economic prospects of emerging countries, especially in South East Asia, attracted portfolio investments in fixed-income instruments such as government and corporate bonds. Lower interest rates also helped improve the creditworthiness of debtor countries borrowing at these rates, thereby facilitating additional capital flows. According to a Harvard Business School study, during the early 1990s rising stock market prices in the emerging markets were associated with declining international interest rates in the developed countries.[10]

There are several other examples that illuminate the correlation between interest rates in developed countries and FPEI flows to

---

[9] World Bank, *Private Capital Flows to Developing Countries: The Road to Financial Integration,* (New York: Oxford University Press, 1997).

[10] Hew Pill, "Portfolio Capital Flows to Emerging Markets" *Harvard Business School Case Study*, No. 9-796-129 (August 1997), p. 3, and p. 12, exhibit 6.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

emerging markets. The interest rate on U.S. Treasury Bills is a good example. The low return on financial investments in developed markets during 1993 helped induce a surge in FPEI flows into emerging markets that same year. On an annual basis over the period 1986-1993, the correlation coefficients between the United States interest rate on Treasury bills and FPEI flows to all emerging markets, FPEI flows to Asia, and FPEI flows to Latin America were 0.7, 0.06 and 0.08, respectively. These statistically significant coefficients indicate that FPEI to emerging markets are influenced by developments in the United States financial markets.

To be sure, high return on fixed-income investments in emerging markets relative to mature markets is an important consideration. The total picture is multifaceted and indicates crosscurrent trends. Among others, one must distinguish between the impact of short-term and long-term interest rates. In the short term, lower interest rates rather than high interest rates tend to have positive impact on both fixed-income instruments (bonds) and stocks. The price of bonds is inversely related to interest rates. When rates go up, the price of bonds declines as new investors have the option of buying bonds that pay higher interest rates. Conversely, when interest rates fall, the price of bonds go higher because the old bond holders receive a higher rate; and because of their high yield relative to the market yield, these bonds become more valuable.

In similar fashion, changes in interest rates impact investors' relative choice regarding the two asset classes: investing in stocks versus bonds. Declining interest rates have a positive impact on stock prices. The positive impact is because the rate of return on stocks relative to bonds becomes more attractive and investors are willing to pay a higher price – or, in the parlance of investments, a higher price/earnings multiple – for securities.

Conversely, rising interest rates make investment in bonds more attractive relative to stocks. Investors in bonds assume lower risks relative to stocks, because upon the maturity of the bond an investor receives the full amount of the initial principal invested. Investors are reluctant to invest in stocks when bond investments have returns closer to stocks but without the additional risk inherent in equity investment. Thus, stock markets of emerging economies, similar to stock markets in developed countries, respond positively to a lower interest rate environment.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Clearly, the long-term secular rise in interest payments for investing in emerging bond markets made these instruments attractive to foreign investors, and foreign portfolio capital inflows sought to take advantage of high returns. However, movements in international interest rates are not the most important determinant, based on the weight of evidence, of the magnitude or composition of capital flows to emerging markets. A recent World Bank study found that the degree of co-movements of flows to emerging markets was significantly lower during the 1993-1996 period compared to the 1990-1993 period. This study further noted that the correlation between American interest rates and total flows to emerging markets is close to zero over the 1990-1996 period, but was negative over the 1990-1993 period. The relatively weak association between the total size of flows to emerging markets and either American or international interest rates can be largely attributed to foreign direct investment (FDI), another type of capital flow. FDI is largely unresponsive to moderate changes in international interest rates. FDI surpassed bank lending to become the largest component of capital flows to the newly industrializing economies of Asia and Latin America, rising from 26 percent of total flows in 1990-1992 to 45 percent in 1995-96.[11]

Performance comparisons of fixed-income debt in emerging markets to such debt in mature markets sheds additional light on the need for a higher return on investment in emerging markets (posing higher risk) than in mature markets (posing lower risks). Figure three shows the yield spread for emerging markets and high-yield U.S. corporate bonds measured by the Merrill Lynch High-Yield Bond Index. The yield spread is wider for the emerging market bonds, which were primarily the so-called Brady bonds, representing some of the most liquid emerging market bonds. The Brady bonds therefore are heavily weighted in the major emerging markets' indices. The findings of a study of private marketing financing for emerging markets is illuminating in this regard. As capital flowed into emerging markets to take advantage of these spreads, which insured a higher rate of return on the bonds, invariably the price of these

[11] See "Capital Data Loanware and Bondware" cited in International Monetary Fund, *International Capital Markets; Developments, Prospects, and Key Policy Issues*. Pp. 30. 31.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

bonds rose, and consequently the spreads declined rather precipitously, and settled by 1996 at the historical rate. Although this historical rate is higher than the American corporate bond rate, the margin is small enough to indicate that changes in interest rates will not bring about a dramatic change in flows.

On the whole, the 'interest rate' explanation has a rather negative implication for the sustainability of capital flows to the developing countries. This explanation implies that capital flows are transitory, merely seeking a temporary high-yielding abode while returns in home markets are depressed. However, for reasons we explore below, the flow of portfolio investment to emerging markets is a structural phenomenon and will continue in the future as institutional investors opt for an optimal internationally-diversified portfolio to manage investment risks.

IV. Structural 'Push' Factors in the International Capital Markets and FPEI

Although there was a pause, and in some instances a reversal, in the FPEI flows to emerging markets in late 1997 and 1998 due to the Asian financial crisis, the trend is toward rising FPEI in the long run. This trend is more due to a structural phenomenon than to a cyclical one, and is highly likely to continue into the foreseeable future. In 1998 and 1999 as the currency crisis in Asia eased, FPEI inflows to Asia have resumed with renewed vigor. One reason is that the rate of economic growth over the long run remains higher in emerging markets than in developed mature economies. In addition, emerging markets offer good opportunities for global financial market participants to diversify portfolio-investment risks. Further, there are several fundamental structural changes in the global financial markets helping to propel portfolio capital flows to emerging markets, and these changes bode well for the sustainability of the FPEI flows in the long term. These changes are, among others, the institutionalization of savings and investment in industrial economies, the growing role of institutional investors, securitization, and the development of a wide variety of financial innovation, especially with derivative instruments. These latter type of financial instruments are particularly noteworthy in that derivative instruments make it possible for institutional investors to manage exposure to risks in emerging markets, including risks related to fluctuating interest rates, changing

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

exchange rates, and credit risks.

There are other noteworthy structural changes that help promote financial globalization and 'push' portfolio investments outside of the mature economies' frontier. Among these are: development of mechanisms through which portfolio investments in emerging markets are channeled, and the revolution in telecommunication and computing technologies. These 'high tech' developments have facilitated the efficiency of global securities markets, and enabled emerging market borrowers and global investors to use derivative products for the management of interest rate and exchange rate risks. As a result, the globalization of the international capital market has permitted greater diversification of wealth holdings. Such diversification is necessary in order to reduce the level of risk as measured by the volatility of its return, as we will elaborate further in this paper.

Earlier we noted that a major structural and secular change in the developed market economies has been the institutionalization of savings and investment, concentrating these financial flows in the hands of institutional investors. Institutional investors – including mutual funds, insurance companies, pension funds, and more recently hedge funds – play a decisive role in the magnitude and final destination of FPEI flows. Here we should note that institutional investors have an identifiable pool of savings in the form of assets under management worth $21 trillion.[12]

Six developed countries (United States, Japan, Germany, England, France, and Canada) hold nearly $38 trillion in savings, and the concentration of these savings in the hands of institutional investors is likely to increase as the need to establish viable pension programs for aging populations grows, necessitating higher return on investment. The search for a higher rate of return on equity investments and the need for diversifying risks associated with these portfolios have been important determinants for the decision of global investors to participate in the equities of the emerging markets economies. To be sure, the size of assets allocated to emerging markets as a percentage of total assets is still relatively small. However, the sheer size of institutional holdings has contributed to

[12] *World Investment Report*, 1997, pp. 115 –118.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the capital flows on a vast scale.

Several financial attributes suggest that the weighting of emerging markets in an internationally diversified portfolio will increase, including: the significant role of institutional investors in the context of the worldwide financial liberalization, the need to diversify across a wide range of assets and regions in order to better manage risks as suggested by the simple portfolio theory, and the increasing weight of developing nations in world stock market capitalization and output. Given this, the flows of such capital will continue over the long term.

The securitization of the global financial markets was a major innovation that served as an important structural factor, 'pushing' portfolio investment to emerging markets. Consequently, indirect finance (or syndicated bank lending), previously the hall-mark of the private capital flows to developing countries, has given way to the use of direct debt and equity markets in which investors, as opposed to banks, hold a tradable direct claim on the borrowing firm. A combination of related factors hase served to facilitate the flow of portfolio investments to emerging markets. These factors included the availability of tradeable securities in conjunction with the creation of exchange-traded futures in which price volatility is securitized, the growing importance of the exchange-traded and over-the-counter stock markets for trading derivative financial instruments designed to manage investment risks, innovation in the pricing of derivative products, and the increasing role of institutional investors in taking huge positions in tradable securities worldwide in order to hedge risk exposure to certain types of asset-price risks, etc.

Related to securitization is the development of new venues or mechanisms in the international capital markets that are making it possible to channel FPEI to emerging markets. Especially noteworthy among these mechanisms are venture capital funds, country funds, American depository receipts and global depository receipts, convertible bonds and bonds with equity warrants. Specialized venture-capital funds are usually two-tiered investment funds, with management provided by professional fund managers from major financial centers, in particular Wall Street and Silicon Valley, California. These venture capitalists have expanded quickly into the Asian emerging markets. The pool of investable venture capital funds in South and East Asia has increased from $500 million to $6 billion

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

within the last decade.

Another vehicle for FPEI flows to emerging markets is the 'international equity investment funds' group. These funds pool the investable funds of a large number of small investors and offer investors professional services and diversification of risks. From 1986 to 1996, the total number of international emerging-equity market funds grew from 28 to 1,435. During this same time, the net asset value of these funds increased from $2 billion to $135 billion. Of the total number of international equity funds as of September 1996, 298 were global, 775 were dedicated to Asia, 239 were dedicated to Latin America, and 88 were dedicated to emerging markets in Eastern Europe. Asia accounted for 48 percent of the net asset value of emerging market funds, followed by Latin America at 11 percent.[13]

Country funds also provide indirect benefits to emerging markets by applying pressure on national governments to improve disclosure and accounting standards, as well as enhance greater transparency. Put differently, in order for private enterprises in emerging markets to attract capital through country funds, these enterprises have to support greater disclosure standards and a regulatory framework that attracts these investments. As such, domestic firms become the force for financial liberalization.

American depository receipts (ADR) and global depository receipts are other investment vehicles that link emerging markets with the global financial markets. ADRs certify the ownership of non-United States companies' securities listed on American stock exchanges and that have been deposited with either the depository bank handling the issue (the depository) or with the depository's custodian bank abroad. Of the total number of 1600 ADRs from 63 countries listed on American exchanges, approximately 50 percent of new issues in 1996 were from emerging markets and represent an increase from 20 percent in 1995. The market value of ADRs traded on American exchanges in 1996 was estimated to be $337 billion. Thus, ADRs have become efficient vehicles for emerging market companies to raise capital in the international financial markets. However, in order to achieve this status, governments in emerging markets were required to liberalize laws regarding financial disclosure

[13] Ibid. p.116.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

and to upgrade their accounting standards so that international investors could assess the value of the enterprise behind the particular ADR listed on American exchanges.

Still another mechanism through which portfolio investments have been channeled to emerging markets is via the 'convertible bonds and bonds with equity warrants.' These bonds are hybrid debt securities that enable bond holders to convert the bond into the stock of the company at a specific number of shares per each bond certificate. These hybrid debt instruments enable companies in emerging markets to attract financing that might otherwise be more difficult to obtain. The 'warrants' attached to these instruments are only expected to be exercised if the company is successful, and if its market value and share price rise above the price at which the warrant can be exercised. Although the size of such securities in developing countries is only $374 billion, and is small compared to developed countries, this market has grown during the past ten years at an astounding average annual rate of 192 percent compared to 21 percent for developing countries. Asian issues of convertible bonds have accounted, on average, for 81 percent of all emerging-market convertible bonds.

The primary reason for such emphasis is that institutional investors are interested in the emerging markets. The emerging-market convertible bond enables institutional investors to lock in the safety of bonds and yet have the option to participate in the appreciation of the underlying equity, in the event the emerging market firms which have offered these bonds grow and their equity prices appreciates.

The success and failure of these mechanisms for the flow of FPEI to emerging markets have important public policy implications. First, governments of the recipient countries will need to provide investors with an attractive tax regime to encourage the flow of FPEI. Attractive tax strategies enable international investors to realize and transfer a substantial proportion of the appreciation in value of the firms in which the funds are invested. Since venture capital is a highly risky enterprise, the rate of return on this high-risk invested capital is expected to be higher than the historical average of 12 percent associated with investing in equity markets. Second, legal transparency and freedom from exchange controls are necessary in order to entice venture capital funds to risk capital by investing in highly risky,

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

unproven emerging business enterprises in developing countries. Third, it is imperative that the government expand the 'exit' options for venture capital and other forms of equity investment. Investors avoid countries with a limited choice of 'exit' options for divesting investments, and this limitation makes it difficult and sometimes too risky to invest in many emerging economies. The realization of a high level of capital gains is warranted by the level of risk that equity investors in emerging markets assume. In countries where local stock markets are relatively illiquid or inactive (stock markets with annual turnover of less that $3 billion) and where stock markets are hindered by government regulatory constraints, capital gains tend to be lower than in countries with an active and liquid capital market.

The revolution in information technology is a vital factor in making it possible for international financial market participants and investors to analyze credit and market risks, manage investment portfolios and price complex derivative products.

The ever-expanding computing capacity to process vast amounts of complex financial information has dramatically enhanced the efficiency of global securities markets to process and manage the issuance of bond and stock offerings and to provide derivative financial instruments to both borrowers and investors in the emerging markets. These derivative products are then used to manage exchange rates, interest rates, and credit risks.

The technological revolution in communication has made the rapid flow of market information possible. Financial liberalization and the speed with which financial information can be transmitted worldwide has intensified and reinforced the globalization of financial markets. Financial globalization means that capital can move more freely and at lower cost. Investors are now in possession of tools and information necessary to move funds quickly between regions, countries, and asset classes. In short, the net result of these technological changes has been to facilitate equity capital flows to emerging markets.

The combination of these structural changes – globalization of international bond and equity markets; the advances in information technologies; the globalization of complex derivative markets designed to manage interest rates, exchange rates and credit risks; and the critically important role of the institutional investors – has fundamentally altered the international environment for the flow of

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

capital to developing countries. The role of bank lending has increasingly declined in importance, as FDI and FPEI have gradually increased to become the dominant form of flows to emerging markets.

V. Role of the United States Government and Non-State Actors

Earlier we noted the important role in attracting FPEI flows of the adoption by major countries in Asia and Latin America of structural economic reforms centering on macroeconomic stabilization and liberalization of the financial and trade sectors. In this regard, the role of the United States as well as the IMF and the World Bank in encouraging governments in Asia and Latin America to adopt policies of monetary stabilization and financial liberalization also deserves special attention.

The United States' privileged position in the global financial system stems from the importance of the dollar in the world economy, the preeminent position of Wall Street in the international financial markets, and the overall size of the U.S. economy. It also stems from two additional fundamental realities: (1) over 30 percent of the global financial assets under management are controlled by American institutional investors;[14] and (2) the United States as the only remaining superpower is in a position to use its geopolitical preeminence to open markets for investment opportunities and push for global financial liberalization, an open trading system, and the free flow of capital. Taken together, these factors give the United States a key leadership role in the provision of global macro-economic stability. We noted earlier that the Federal Reserve has become a *de facto* central bank for a vast number of countries, including the emerging markets. Further, the United States is in a position to create incentives and disincentives to facilitate an open trading system and promote financial liberalization. As Eric Helleiner has argued, American interests played an important role in triggering competitive deregulation of financial markets in the emerging economies and worldwide. Free and open financial markets helped the United States finance its huge current account and fiscal deficits.

---

[14] International Monetary Fund, *International Capital Markets; Developments, Prospects, and Key Policy Issues.* Pp. 243-265.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The United States has used this strategic position directly and through the IMF and World Bank to encourage capital market liberalization in emerging market economies.[15]

By abandoning the fixed exchange rate regime envisioned in the Bretton Woods system and the concomitant significant exchange rate fluctuations, the United States recognized that new financial instruments (derivative products, for example) were necessary to limit, absorb and cover foreign-exchange risk. Liberalization of exchange control over equity capital was crucial for the development and use of these new products.

On their parts, both the IMF and the World Bank have insisted on the adoption of public policy measures – the lifting of capital controls, in particular, as one of several conditions for approving loans – by host governments that enhance the attractiveness of borrowers to international investors. Hew Pill has thus summarized the role of these international institutions:

> The late 1980s saw the triumph of the 'Washington consensus' on economic policy. Sponsored by the International Monetary Fund (IMF) and World Bank, this prescribed macroeconomic stabilization, based on fiscal balance and tight monetary policy, and structural economic reform, centered on liberalization of the financial and trade sectors and privatization of public enterprises and services.[16]

In the wake of the 1994 Mexican crisis, one major new demand was added to the list of the IMF conditions for financial aid to emerging market countries. This demand has been that the currencies of all member countries be convertible for all capital transactions in order to lock in the freedom of capital movements. This new condition, recommended by the IMF's managing director Michel Camdessus, went a long way toward encouraging an ever-wider

---

[15] Eric Helleiner, "State and the Future of Global Finance," *Review of International Studies,* Vol. 18 (1992), pp. 31-49; See also Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca, NY: Cornell University Press, 1994).

[16] Hew Pill, "Portfolio Capital Flows to Emerging Markets" *Harvard Business School Case Study*, p.4

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

liberalization.[17]

In a similar vein, the affiliates of the World Bank, and the International Finance Corporation, have sought to foster stock market development in the developing countries and have encouraged emerging markets' governments to open their capital market to foreign portfolio investment. In the last two decades the International Finance Corporation has promoted, for example, venture capital funds in developing countries in an effort to improve the access of small and medium-sized firms to financing in the capital markets and to management expertise that a venture capital enterprise brings. In this regard, the role of the International Finance Corporation, an affiliate of the World Bank, is especially important. The International Finance Corporation has marshaled, for example, the expertise of institutional investors, investment banks and fund managers in structuring funds, identifying fund managers and placing funds. By 1996, it had invested $196 million in 49 venture capital funds, with a total initial capital of $1.5 billion.[18]

To expand such efforts and achieve the broader goal of liberalization in the international financial markets, the World Bank and the IMF have insisted on financial liberalization by the host governments. Indeed, encouraging the growth of stock markets is the *sine qua non* of the World Bank's proposal for pension reform in the emerging market countries.

The fundamental belief underlying the position of the American government, IMF and the World Bank is that the free flow of capital would make financial markets more efficient, would bring about the convergence of long-term interest rates and would thereby optimize the global allocation of capital across national border.[19]

IV. Public Policy Implications

The extent to which international interest rates – the rate on

---

[17] John Eatwell, "International Financial Liberalization: The Impact on World Development," *United Nations Development Program*, Office of Development Studies (New York: United Nations, 1996) pp. 6-8.

[18] World Investment Report, pp. 115-116.

[19] Ibid.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

American Treasury Bills in particular – influence FPEI flows to emerging markets has important implications for public policy and for the sustainability of such flows in the future. The Federal Reserve decision to tighten monetary policy and the consequent rise in interest rates could make investment in Asia and Latin America less attractive. During early 1994, for example, the rise in the United State's prime rate, in response to Federal Reserve tightening of monetary policy, lessened the attractiveness of investments in debt instruments such as government bonds in Asia and Latin America.[20]

More importantly, a decision by the Federal Reserve to raise the discount rate or the Federal Fund's rate not only adversely impacts stock markets in the United States, but increasingly these actions on interest rates have similar impacts on the stock markets in the emerging markets. In light of the cyclical nature of interest rates, the trend in FPEI is at least partly a cyclical one, exposing emerging market economies to cycles of booms and busts in FPEI flows. In formulating monetary policy and/or seeking to increase national reserves, policy makers will need to be alert to the consequences of interest rate cycles for portfolio capital flows.

However, we should not exaggerate the negative impact of rising interest rates in the developing **Roger, don't they mean "developed" here?** countries on the sustainability of capital flows to the developing countries. Portfolio capital flow is not a transitory phenomenon. Contrary to the 'interest rate explanation,' the flow of FPEI to the emerging markets is not simply based on the search for a temporary high-yielding abode while returns in home markets are depressed. The trend of rising FPEI in the long-term is more of a structural phenomenon than a cyclical one. Rising FPEI will continue, for several reasons.

One reason over the long run is that the rate of economic growth going forward remains higher in emerging markets than in developed mature economies. Another structural change has been the extremely important role of institutional investors as the dominant players in the global financial markets. These lead actors opt for optimal international portfolios, so that investment portfolios are

---

[20] Ilan Goldfajn, and Rodrigo O. Valdes, 1997, "Capital Flows and the Twin Crises; The Role of Liquidity" *IMF Working Paper 97/98* (Washington; International Monetary Fund, 1998.)

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

diversified across a wide range of assets, countries and regions in order to manage market and portfolio investment risks.

Further, portfolio capital flows will continue to be propelled toward emerging markets by institutionalization of savings and investment in industrial economies, securitization, the development of a wide variety of financial innovation, and several other fundamental structural changes in the global financial markets. These changes bode well for the sustainability of FPEI flows in the long term. A related structural change in the global financial markets has been the development of new mechanisms in the international capital markets that make it possible to channel FPEI to emerging markets: country funds, venture capital funds, American depository receipts and global depository receipts, etc.

These new venues have profound consequences for national governments. For example, managers of country funds have collectively been a source of pressure on national governments in the emerging markets, pushing governments to improve standards of disclosure, accounting, and greater transparency. Similarly as a group, these institutional investors have been the primary transnational constituency pushing the American government, IMF, and World Bank to put pressure on emerging governments to adopt higher standards of disclosure. Ultimately, investors' power *vis-a-vis* national governments in the emerging markets and developing countries stems from the dollars being wielded, which will not flow to private enterprises in these countries without greater disclosure standards, financial liberalization, and a regulatory infrastructure for local stock markets. Since domestic firms in developing countries in which these global investors take investment positions will continue to become the beneficiaries of such flows, these local firms, in turn, are highly likely to become a major local ally and a force behind further financial liberalization in the emerging markets, and in those developing countries that wish to attract FPEI.

The success and failure of these new mechanisms for the flow of FPEI to emerging markets have important public policy implications. First, one major goal of international investors is to realize and transfer a substantial portion of the appreciation in value of the stock of firms in which the funds are invested. Governments in the recipient country that seeks FPEI inflows as a source of capital for development are advised to provide investors with an attractive

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

tax regime. As already intimated, this is especially true of foreign venture capital funds. Since such investment is a highly risky enterprise, naturally the rate of return expected on invested capital is higher than the historical average of 12 percent associated with investing in equity markets. Second, in order to entice venture capital funds to risk capital by investing in highly risky yet untested and emerging business enterprises in developing countries, governments in these countries should try to optimize legal transparency and provide venture capital investors freedom from exchange controls. Third, a key factor that entices FPEI inflows, venture capital in particular, is the availability of 'exit' options, allowing institutional investors to sell their stock and bond positions, repatriate their capital, and thus 'exit' the market should they so choose. It is imperative for countries in emerging markets that wish to attract FPEI to provide a regulatory framework that will allow capital to exit. Usually, the limited choice of 'exit' options for divesting investments makes it difficult and sometimes too risky to invest in many emerging economies. In countries where local stock markets are relatively illiquid or inactive (stock markets with annual turnover of less that $3 billion), and where stock markets are hindered by government regulatory constraints, capital gains tend to be lower than in countries with an active and liquid capital markets.

While these cyclical and structural factors 'push' portfolio equity investments in the direction of the emerging markets, ultimately the specific economic, public policy and financial environments in a particular country and region serve to 'pull' capital inflows and shape the direction and final destination of FPEI. In this regard, we find that several national "pull" factors play an important role for attracting foreign portfolio equity capital. Certainly, the key factor is the rate of economic growth. Those economies with the fastest economic growth have attracted FPEI. Further, in this competitive global financial market-place, the governments that will fare best in attracting FPEI as a source of capital for economic development are those maintaining fiscal balance and tight monetary policy, engaging in structural economic reforms centered on liberalization of the financial markets, trade sectors and the privatization of public enterprises and services, and demonstrating commitment to the development of domestic stock markets.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Mankind Quarterly

A quarterly journal of broad human studies including both cultural and physical anthropology

CONTENTS OF VOLUME XXXVI

Bowden, Edgar: Caucasus-Aegean-Etruria: A Bronze Age Etrusco-Luwian Connection; **Buchvarova, Maria**: Rates of Growth of Gypsy Children from Birth to One Year of Age Compared with Bulgarian Children; **Carey, Arlen D. and Joseph Lopreato**: The Biocultural Evolution of the Male-Female Mortality Differential; **Chang, Rosanna H. and Richard A. Dodder**: Conceptualization of Aging in a Cross-National Context; **Christensen, Jesper**: Heaven and Earth in Ice Age Art: Topography and Iconography at Lascaux; **Damjanovich, Jovan**: Genetic Distance between non-Moslem Macedonians, Macedonian Moslems and Albanians; **Dhima, A., K. Kume, Z. Bajrami, and I. Mikerczi**: Analysis of Nonmetric Cranial Traits in Recovered Human Skeletal Collections in Albania; Dinev, Valeri: Evolution, the Brain and the Arts; **Eisenman, Russell**: Men, Women and Sex Differences: The Attitudes of Three Feminists; **Jamieson, J. W.**: Biological Diversity and Ethnic Identity: Changing Patterns in the Modern World; **Lamb, Kevin**: The Causal Factors of Crime: Understanding the Sub-Culture of Violence; **Miller, Edward M.**: Breasts: Evolutionary Origins as a Deceptive Signal of the Need for Provisioning and Temporary Infertility; **Nix, Dennis**: The LSAT and Affirmative Action in U.S. Law Schools; **Pearson, Roger**: The Concept of Heredity in the History of Western Culture; **Piscova, Magdalena and Richard A. Dodder**: Demographic Trends Impacting the Family in Slovakia, 1988-1993; **Rahman, Tariq**: Languages of the Proto-Historic Indus Valley; **Rietdijk, C.W.**: Some Dysgenic Tendencies in the Netherlands; **Wierciński, Mateusz**: Some Problems in the Demography of the Tribal Populations in India; **Wolanski, Napoleon**: Non-Genetic Family Factors and Development of Schoolgirls from Progresso in Mexico

LIBRARIES & INSTITUTIONS $80.00 PER ANNUM
ISSN 0025-2344

P. O. Box 34070, NW Washington DC 20043
Tel: (202) 371-2700 Fax: (202) 371-1523

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Poverty Trends in a Metropolis

Robert G. Mogull[1]
California State University at Sacramento

Objective. This study develops a technique to estimate and project annual rates of poverty for various population segments within a metropolitan area. *Methods.* The annual estimates and projections are based upon official rates of poverty compiled by the Census Bureau. The setting for the study is the Los Angeles/Long Beach SMSA/PMSA and covers the years 1959 through 2000. Using Census benchmark years, linear regression models are developed for All Residents, Whites, Blacks, Hispanics, Female Family Heads, the Elderly and Children. *Results.* The evidence reveals an increasing trend in the incidence of poverty for the overall metropolitan population. This increase is caused by dramatic rises within the Hispanic and the Children population subgroups. Poverty trends are negative, however, for the Elderly, Blacks, Female Family Heads and Whites. *Conclusion.* The evidence for the Los Angeles/Long Beach metropolitan area mirrors the overall findings for the state of California.

Key Words: Poverty, Los Angeles, Long Beach, Hispanics, whites, blacks, children

Article I, Section II of the U.S. Constitution specifies that an enumeration of the population shall be made every 10 years. Consequently, the Bureau of the Census conducts decennial counts of the population and, at the same time, compiles data on family and individual incomes (for the year immediately preceding each census year). Since 1960, the Bureau also estimates poverty at 10-year intervals for the nation, regions, states, counties, urban and rural areas, and tracts. The census surveys of poverty have been obtained from samples ranging from 15% to 25% of housing units.

Since 1960, the Bureau has also obtained annual survey data on income and poverty (for 1959 on) and has published it in March issues of the *Current Population Reports*. This data has been

[1] Professor of Business Statistics, College of Business Administration, California State University at Sacramento, 6000 J Street, Sacramento, CA 95819-6088, E-mail: mogullr@csus.edu

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

collected, however, only for the nation and for states. These annual Current Population Surveys are based upon national samples over the years of between 33,500 and 65,500 noninstitutional civilian households. But, except for the decennial censuses, no data on poverty have been compiled regularly for *sub*state levels.

The purpose of this study is to establish a methodology to provide annual estimates of poverty for an *urban* area over time. The methodology is patterned after a technique that was used successfully in obtaining time series estimates for the *state* of California (Mogull, 1991, 1993, 1998). According to one prominent observer, "The real importance of a ... poverty measure is not the number who are poor in any one year but the indicator's ability to show whether the number is decreasing or increasing over time" (Primus, 1995:27). The assumption made by the planned methodology is that smoothed linkages between the benchmark years (which have been established by the decennial censuses) will yield a valid and reliable charting of long-term trends.

Methodology and Data

As an example, annual poverty estimates and projections will be created for the Los Angeles/Long Beach Standard Metropolitan Statistical Area (SMSA) since 1959 and Primary Metropolitan Statistical Area (PMSA) since 1983. This urban area is currently the second largest in the nation and the largest west of the Mississippi River, with a Consolidated Metropolitan Statistical Area population in 1996 of nearly 15 million. Annual rates of poverty will be estimated and projected separately for seven (nonmutually exclusive) segments of the population – All Residents, Whites, Blacks, Hispanics, Female Family Heads (without a resident spouse), the Elderly (age 65 and over), and Children (related by blood or adoption to the householders and under the age of 18).

So far, official estimates of poverty have been established by the Census Bureau for the years 1959, 1969, 1979 and 1989 (Bureau of the Census, 1972, 1973abc, 1975, 1985, 1993). These estimates are to be used here as benchmarks or points of reference. Long-term linear trends will be computed from these points for each separate demographic group to reveal smoothed patterns. Annual interim estimates of poverty will be determined from the trend lines. The trends will be extended to the year 2000, when a new point of

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Table 1.

Official Poverty Rates for Los Angeles/Long Beach

Percentages

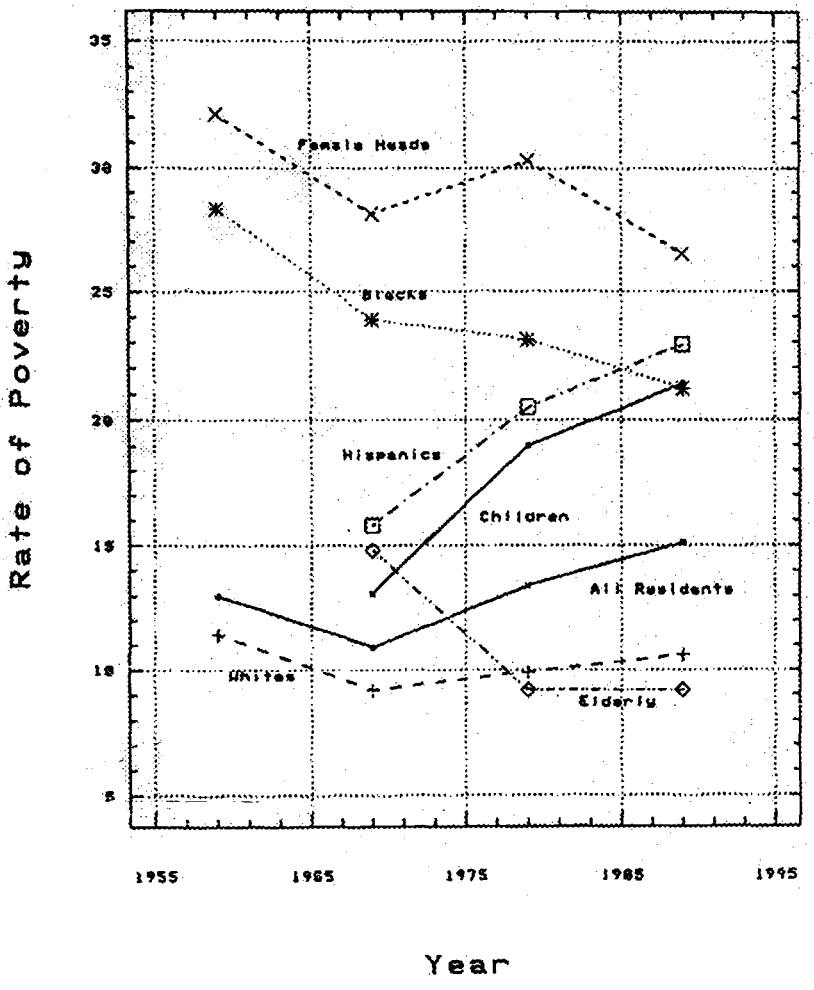
Group	Year			
	1959	1969	1979	1989
All Residents	13.0	10.9	13.4	15.1
Whites	11.4	9.2	9.9	10.6
Blacks	28.3	23.9	23.1	21.2
Hispanics	na	15.8	20.5	22.9
Female Family Heads	32.1	28.1	30.3	26.5
Elderly	na	14.8	9.2	9.2
Children	na	13.1	19.0	21.4

na = not available.

Source: Bureau of the Census, U.S. Department of Commerce.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Figure 1.
Official Poverty Rates: 1959-1989



LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

reference will become available from the Census Bureau.

The Census benchmark years are those when income levels were estimated, rather than the years when populations were counted. The linear trend in years will serve as an overall proxy for a variety of social and economic forces which affect poverty rates over time.

The Evidence

Table 1 presents the officially tabulated rates of poverty for each of the seven population groups which have been classified by the Census Bureau for the Los Angeles/Long Beach SMSA/PMSA for the years 1959, 1969, 1979 and 1989. These rates are the discrete benchmark data points upon which the trends are based.

Figure 1 traces the seven separate paths over time by connecting the individual sets of points. As indicated by the official estimates, the category of Female Family Heads is consistently highest. The next highest set of poverty rates is exhibited by Blacks. However, according to the most recent census, the incidence of poverty within the Hispanic sector had overtaken that of Blacks. And, closely mimicking the rates for Hispanics are those for Children. The lowest rates appear for All Residents, followed by those for Whites and then for the Elderly.

In examining the evidence, it should be kept in mind that the seven population segments are not mutually exclusive. Of particular interest is that the Hispanic sector especially includes Children. The correlation between the poverty rates of these two groups is +.9985, which is significant at the .03 alpha level. (Statistics on correlation are not separately shown.) Hence, rising poverty rates within these two sectors are very closely interrelated. And, it is a two-way effect. The typical low family income of Hispanics results in low incomes for their children and, therefore, for the category of all Children. But also, the traditionally large Hispanic families incur a strain on their already limited family resources and feeds back to contribute to the high incidence of Hispanic poverty.

Further, the increasing rate of Hispanic poverty also lifts the rate for All Residents. This is particularly true as the Hispanic share of the total population expands over time. (The correlation between the poverty rates of Hispanics and All Residents is +.9972, which is significant at the .05 level.) Thus, poverty in this metropolis is tied closely to both the numbers and the internal finances of the Hispanic

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Table 2.

Trend Models

Group	Specific Regression[a]	r^2	F	n	S.E. of Est.	MAPE[c]
All Residents	$\hat{P} \cong -160.6 + .088Y$	43	1.53	4	1.59	7.8
Whites	$\hat{P} \cong 43.8 - .017Y$	5	0.11	4	1.12	7.2
Blacks	$\hat{P} \cong 460.4 - .221Y$	90	18.31[b]	4	1.15	2.7
Hispanics	$\hat{P} \cong -682.8 + .355Y$	97	28.59	3	0.94	2.6
Female Family Heads	$\hat{P} \cong 317.5 - .146Y$	59	2.86	4	1.93	4.2
Elderly	$\hat{P} \cong 565.2 - .28Y$	75	3.00	3	2.29	12.2
Children	$\hat{P} \cong -803.5 + .415Y$	94	16.87	3	1.43	4.4

[a] P = Percent poverty.

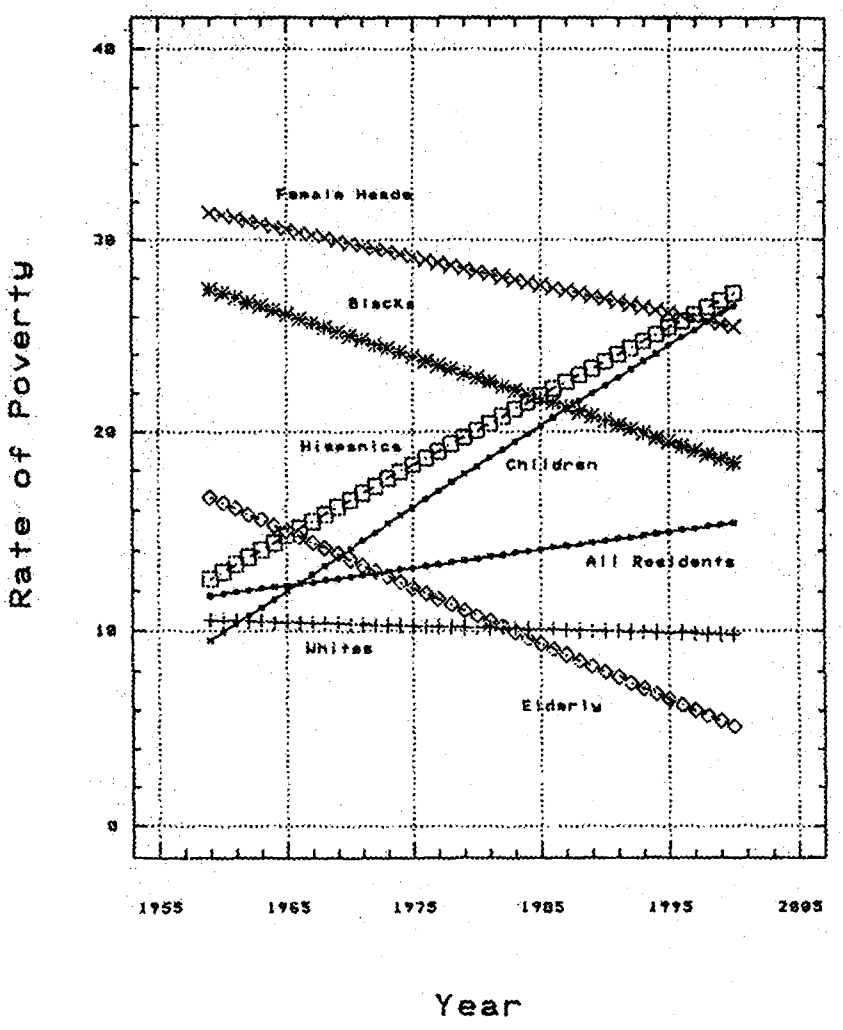
Y = Year.

[b] Significant at .05 alpha level.

[c] $MAPE = \sum_{i=1}^{n} [(|e_i|/P_i)100)]/n$, where $e_i = (P_i - \hat{P}_i)$.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Figure 2.
Trended Poverty Rates: 1959-2000



LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

population in particular. This evidence mirrors the pattern observed at the state level, where poverty was traced for these groups over the same time frame (Mogull, 1998:630).

The Trended Evidence

Table 2 presents the regression results for each separate group. The regressions express rates of poverty as linear functions of the years of data. Each specific regression equation is accompanied by a coefficient of determination (r^2), the model's test statistic (F), sample size (n), and two types of measurement errors (the Standard Error of Estimate and the Mean Absolute Percentage Error).

The qualities of the results are mixed. The best linear "explanations" of the variations in data are obtained for Hispanics, Children and Blacks – as revealed by the largest r^2 and F values. Moderate results in these categories are obtained for the Elderly, Female Family Heads and All Residents. Poor results are obtained for Whites, however. This is due to the essentially horizontal path over time of White poverty rates. When measurement errors are examined, the S.E. of Estimates (ranked from best to worst) are for Hispanics, Whites, Blacks, Children, All Residents, Female Family Heads and the Elderly. According to the MAPE's, the best (i.e., smallest) values are obtained for Hispanics, Blacks, Female Family Heads and Children. Midway are the values for Whites and All Residents, while it is largest for the Elderly.

As shown in Figure 2, although the poverty rates are generally highest for Female Heads and Blacks, their descents to the year 2000 are steep. The smoothed downward trend is especially strong for the Elderly, where the rate in year 2000 (5.2%) is projected to be less than one-third the rate in 1959 (16.7%). In contrast, the trend is only slightly negative for Whites (from 10.5% to 9.8%). These downward trends are indicated by the magnitudes of the slope coefficients (in Table 2), which range from -.28 for the Elderly to only -.017 for Whites. The slope coefficient in the White model is roughly zero, which means that the White rate of poverty has changed very little over the time frame examined. This horizontal slope is the cause of the low r^2 coefficient in the regression. That is, Years cannot "explain" or account for variation in a variable which has remained basically unchanged.

In contrast to the negative trends for the aforementioned

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

groups, there are strong upward movements among Hispanics and Children. The rate for Hispanics in year 2000 (27.2%) is projected to be more than twice the rate for 1959 (12.6%). And, the poverty rate for Children will be almost triple what it was in 1959 (26.5% versus 9.5%). The upward trend for All Residents is more gradual, where the incidence of poverty is projected to rise from 11.8% in 1959 to 15.4% in 2000.

As discussed above, the paths of Hispanics and Children are closely interrelated. This is statistically revealed here by the closeness in magnitudes of their slope coefficients (+.355 and +.415, respectively) and by their roughly parallel trend lines in Figure 2. The absolute strengths of the slope coefficients for these two groups are largest among all seven groups. These powerful upward trends for the two groups are indeed ominous for the LA/LB metropolitan area (as they also are for the state).

The overall rate of poverty for the general population of LA/LB is projected to rise substantially through the year 2000. This increase appears to be a direct consequence primarily of the large and rapidly growing Hispanic sector and its offspring. In contrast, the incidence of poverty within each of the other *measured* population segments is declining. However, the upward trends for Hispanics and Children more than offset the declines among the other groups.

Summary

This paper has discussed a technique designed both to estimate annual rates of poverty for a large metropolitan area and to project poverty trends for segments of the area's population. The annual estimates are designed to fill in for the absence of official data provided by a governmental agency. The projections are constructed as an application and an extension of the annual estimates. The annual estimates and the projections are based upon discrete benchmarks provided by the Bureau of the Census.

The Los Angeles/Long Beach SMSA/PMSA was selected as the site for development and examination of the technique. The evidence specific to this metropolitan area are presented in tables and figures. The annual rates of poverty and the projections are computed from the specific regression equations which appear in Table 2. Figure 2 illustrates the smoothed linear trend lines for the years 1959 through 2000.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The resulting trend lines indicate a gradual increase in the incidence of poverty for the overall metropolitan population. This increase is the net result of declines in rates within the sectors for the Elderly, Blacks, Female Family Heads and Whites and the increases for Children and Hispanics. There is also evidence that the two population segments with the rising rates are closely interdependent. Rapid growth in the impoverished Hispanic population generates a corresponding rapid growth in poverty among Children. But also, high fertility rates within Hispanic families feeds back to cause greater Hispanic poverty. This evidence for Los Angeles/Long Beach mirrors the findings at the state level.

References

U.S. Bureau of the Census.

1972. *Census of Population, 1970: General Social and Economic Characteristics, California.* Washington, D.C.: GPO.

1973a. *Census of Population, 1970: Characteristics of the Population, Detailed Characteristics*. Washington, D.C: GPO.

1973b. *Census of Population, 1970: Subject Reports, Negro Population.* Washington, D.C.: GPO.

1973c. *Census of Population, 1970: Subject Reports, Persons of Spanish Origin.* Washington, D.C.: GPO.

1975. *Census of Population, 1970: Supplementary Report, Poverty Status in 1969 and 1959 of Persons and Families, for States, SMSA's, Central Cities, and Counties: 1970 and 1960.* Washington, D.C.: GPO.

1985. *Census of Population, 1980: Subject Reports, Poverty Areas in Large Cities*. Washington, D.C.: GPO.

1993. *Census of Population, 1990: Social and Economic Characteristics, Metropolitan Areas*. Washington, D.C.: GPO.

Mogull, Robert G.

1991. "Annual Estimates of California's Poor: 1959 Through 1990. "*American Journal of Economics and Sociology* 50:299-312.

1993. "Annual California Poverty Estimates: Updated and Revised for 1960-2000." *American Journal of Economics and Sociology* 52:241-245.

1998. "The Incidence of California Poverty by Population Segment." *The Social Science Journal* 35:627-634.

Primus, Wendell.

1995. "Comments." *Focus* 17:27.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Economic, Political, and Social Influences on Electric Utility Regulation in the Georgia Public Service Commission

David R. Kamerschen and Jeff Reynolds[1]
University of Georgia

Regulation is a dynamic and complex issue that has sparked controversy recently and deserves a closer look. While this paper concentrates on regulation in one state (Georgia) and in one specific industry (electric utilities), we believe that it has application for other states and other regulated industries. We find that economic, political, and social factors affect state regulation. The economic variables affect private efficiency relations, the political variables affect governmental power relations, and the social variables affect private equity or fairness relations. In our opinion, for the short-run at least, some kind of regulation is still necessary. However, it is instructive to consider some alternatives. In our view, the best current alternative is reorganized commission regulation coupled with partial or semi-deregulation rather than government ownership or complete deregulation.

Key Words: Georgia Public Service Commission, natural monopoly, subadditivity, pure discrimination, deregulation, privatization, electric utilities; economic, political and social influences.

In 1877, *Munn vs. Illinois* gave states the right to regulate price charges by firms whose economic power tempted them to exploit their customers. The court ruled that, "When private property becomes affected with a public interest, the owner must submit to such controls as might be established for the common good" (see e.g. Denning and Mead, 1990, p. 21). By 1914, more than half the states in the U.S. had public utility commissions controlling electric rates and services. By 1976, all states having investor-owned or private electric power companies had state regulation. Privately owned

---

[1] The authors are Distinguished Professor and Dorsey Chair Holder and former student in the Department of Economics, The University of Georgia respectively. We are indebted to Dr. David B. Robinson for his valuable comments.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

plants generate and sell a majority of the power in Georgia, and these are regulated by the Georgia Public Service Commission (GPSC).

The GPSC has been criticized and praised for its regulatory actions and policies. Several relevant questions have been asked about GPSC regulation in general and the electric utility industry in particular. Why are public interest and natural monopoly given as the primary justifications for GPSC regulation, and what are their rationales? What effects do economic, political and social variables have on the decision-making and regulatory procedures of the GPSC? What are the benefits and costs of the GPSC's regulation of the electric utility industry, and what are the alternatives? The most important issue to the consumer is whether the ratepayer – residential, commercial, and industrial – can obtain equitable rates along with reasonable service. The most important issue to the utility is whether it can earn a reasonable rate of return by operating efficiently. And the most important issue to the GPSC is whether it can balance the economic, political and social factors so as to generate efficient and equitable prices and profits. The economic, political and social variables need to be examined and alternatives explored. The economic variables affect private efficiency relations, the political variables affect governmental power relations and the social variables affect private equity or fairness relations. With regard to all the questions, complexities, and dynamics of regulation, Gormley (1983, p. 27) sums it up admirably when he says, "The regulator needs the patience of Job, the wisdom of Solomon and the optimism of Sisyphus." While this paper concentrates on regulation in one state (Georgia) and in one specific industry (electric utilities), we believe that it has application for other states and other regulated industries.

Origins and Functions of the GPSC

The GPSC is one of the oldest commissions in the United States, created by the Act and Resolutions of the General Assembly of the State of Georgia in 1879 as the Railroad Commission of Georgia (see NARUC, 1989). The term of office was fixed at six years, which is still true today. In 1907, the number of commissioners, elected by the state, was increased from three to five. One of the five is elected chairperson by the commission. In 1920, the name was changed to the Georgia Public Service Commission. The

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

commission was made a constitutional body in 1943. The GPSC has jurisdiction over major utilities such as railroad, telephone, gas and electric utilities. All actions of the GPSC are concluded as a result of a majority vote of the GPSC in executive session. Finally, enforcement of laws over which GPSC has jurisdiction is in the courts, and the GPSC is authorized to issue only administrative orders. In short, the GPSC is charged with the protection of the public interest, and it regulates prices, entry, and conditions and quality of service. Its rulings must be consistent with statutory law and due process and are subject to judicial review.

The Natural Monopoly Phenomenon

There are two views about regulation.[2] The special-interest group states that firms, consumers, and other groups pressure legislatures and regulators to promote their interests, thereby creating market inefficiencies, and that regulators lack the information to regulate optimally anyway. The public-interest view opines that regulation can and does correct market inefficiencies. This approach emphasizes that electric utilities are a natural monopoly and hence in need of regulation. The historic prerequisites for a natural monopoly are decreasing long-run costs or economies of scale. According to the public-interest theory, decreasing costs prevail for public utilities. Increasing or constant costs are generally considered the condition in which competitive enterprises operate. Most natural monopolies, such as local electric companies historically, have very high fixed costs and low marginal costs. With long-run decreasing costs, an increase in the output of an electric utility plant will lower the production costs per kilowatt hour for the customer. Assuming input prices are held constant, long-run decreasing costs occur as a result of increasing returns to scale. Long-run economies of scale are thought to occur because of specialization, division of labor, unexpected excess capacity, discounting and advertising (see e.g. Bonbright, Danielsen, and Kamerschen, 1988, p. 22). Thus, traditionally an electric utility with decreasing long-run costs throughout its entire output range along with a localized market (supply of service in a

[2] These two views are discussed in any modern treatments of regulations such as Bonbright, Danielsen and Kamerschen (1988), Carlton and Perloff (2000), and Church and Ware (2000).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

designated area) and some kind of barrier to entry was considered a natural monopoly. Kahn (1971, pp. 11, 123) summarizes the historic prerequisites of the natural monopoly: "Their costs will be lower if they consist in a single supplier" and "A 'natural monopoly' is an industry in which the economies of scale – that is, the tendency for average costs to decrease the larger the producing firm – are continuous up to the point that one company supplies the entire demand."

The modern prerequisite for the existence of a natural monopoly is subadditivity of costs rather than economies of scale. Subadditivity of costs exists when all the industry output or array of outputs demanded can be produced most efficiently only by a single firm. Subadditivity of costs renders competition unfeasible. Baumol (1977, p. 809) argues that subadditivity is the proper criterion for defining a natural monopoly, since it implies that every output combination is always produced more cheaply by a single firm. Moreover, economies of scale are neither necessary nor sufficient for a natural monopoly, although if economies of scale are present, subadditivity of costs is probably present. Thus, in an electric utility firm where the output or outputs are produced more efficiently by one firm because the cost-minimizing design is a single firm (i.e., subadditivity costs are present), where there are barriers to entry, and there is a localized market, the firm can be called a natural monopoly in the modern view.

Technological factors are also juxtaposed with the prerequisites of a natural monopoly. First, the physical connection of the electric utility consumer with the producer, which involves transmission lines and generation facilities, contributes to heavy fixed costs. Second, the simultaneity of production and consumption, for this nonstorable service electricity, which involves varying production through time and the need for excess capacity, at times contributes to heavy investment. These technological requirements create economies of scale so great that they can cause bankruptcy or inefficient use of resources that make duplication or competition unfeasible.

Two Related Rationales For Electric Utility Regulation

Two rationales related to the public-interest approach for regulation of the electric utilities are price discrimination and reasonable service. Public-interest supporters believe that regulation

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

is necessary to insure reasonable rates and reasonable service. Without regulation the utility will allegedly practice undue price discrimination, and service will suffer.

Price discrimination is defined as price differences not based on differences in costs; more specifically, it involves charging prices for similar commodities that are not accounted for by costs in production, transportation, distribution, storage, risk, or uncertainty. To understand price discrimination fully we must understand direct price elasticity of demand. If demand is elastic, the firm's total revenue decreases as price increases; if demand is inelastic, total revenue increases as price increases; if demand is unitary elastic, total revenue is constant. If all other things remain the same, the elasticity of a commodity will be less if there are fewer and poorer substitutes for it and the commodity is relatively indispensable. The empirical studies indicate that price elasticity of demand for utility services is relatively inelastic (see e.g. Howe and Rasmussen, 1982, p. 20 and Patrick and Wolack, 1997). Consequently, as the price of electricity rises, the consumers will not substantially reduce consumption. The more inelastic the demand, the greater the income that can be redistributed from the electric utility consumer to the producer. When an unregulated monopoly charges a uniform rate to all customers, a rate determined by cost functions and elasticities of demand that create profit-maximization or best price for the utility, monopoly pricing exists. The regulation of a natural monopoly is often supported to protect consumers from monopoly pricing.

Departures from a uniform rate without cost justification is price discrimination. There are three types of price discrimination. In first- or perfect-discrimination, each consumer pays different rates, the monopolist gains all the consumer surplus, and the result is Pareto optimal. Second-degree price discrimination occurs when a firm cannot identify individual consumers so it constructs pricing schemes that are the same for all consumers, but since some consumers buy more than others, the average and marginal prices may differ among consumers. Third-degree price discrimination is when a firm is able to separate the market between groups of consumers with differing demands, so that higher prices are charged to groups with more inelastic demands. Price discrimination by an unregulated monopolist results in a larger profit than charging a uniform price. For example, residential demand for electricity is less

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

elastic than industrial. Thus, industrial users pay lower rates than residential users. If price discrimination utilizes capacity to improve resource allocation, it may be considered acceptable because the transfer of consumer surplus through increased output leads to more efficient resource allocation, albeit at the possible expense of equity.

Not all price discrimination is acceptable, and not all is unacceptable. "Undue price discrimination" exists in the eye of the beholder, or more technically, in the perceptions of the commissioners and courts that decide what constitutes "undue price discrimination." An unregulated utility has a profit incentive to price-discriminate, provided that the market has clearly definable user groups with different price elasticities of demand and where resale from one group to another can be severely restricted by market segmentation. Furthermore, since the electric utility industry meets these requirements, undue price discrimination may exist according to the perceptions of the commissioners that might make regulation necessary to bring about reasonable rates.

The second rationale for regulation is reasonable service. Public-interest supporters warn that if a utility is operating under conditions of a natural monopoly, it is the only supplier of the service. Consequently, the firm controls reliability, termination, and partial abandonment of utility service. The reliability of service can be measured by the ability of the utility to maintain the supply of power and is measured by the infrequency of interruption, the size of the area affected, and the speed at which the power supply is restored (see e.g. Phillips, 1988, p. 610). Reliability of service is essential. For example, an electric blackout (prolonged stoppage of service) or brownout (temporary stoppage of service) in cities such as Atlanta is not only an inconvenience; it could also be a disaster socially (public safety) and economically (lost business or night looting). Public-interest supporters argue that regulated utilities offer continuous and constant reliable service, and if the utility were unregulated it might be selective. There may be welfare gains for the producer with selective decreases in reliability of service, as the unregulated monopolist could manipulate rates to different customers, also allowing welfare gains for selected customers at the expense of service that could lead to a breakdown in service for all customers (see Berg and Tschirhart, 1988, p. 217).

Two other service factors used to support regulation are

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

termination and partial abandonment of service. Termination of service occurs through non-payment of a bill or violation of a rule. Without regulation there would be no requirements for due notice of discontinuance. Most states have regulatory policies that guarantee the right of notification before termination such as those set forth by the Colorado Commission, which are similar to the GPSC's (see Phillips, 1988, p. 513). With state regulation, customers are protected regardless of their economic status and receive due notice of termination. Partial abandonment of service is initially proposed by the utility. The Commission with jurisdiction has the authority to approve or disapprove the request. If the utility is earning an adequate return, it can be required to continue the operation of unprofitable services to those customers. If regulation did not exist, the utility could discriminate with regard to partial abandonment and service only those customers or areas it deems profitable. Some kind of regulation is necessary to prevent undue price discrimination and unreasonable service.

Political Variables and the Regulation Process

Regulatory commissions such as the GPSC have executive functions and have also been characterized as quasi-judicial and quasi-legislative. The commissions defy the doctrine of separation of powers. Instead, they act as administrator, judge and legislator. When acting as an administrator, they investigate rates and service. When acting as a judge, they hold hearings, examine evidence, and make decisions. When acting as a legislator, they prescribe detailed standards and rules for the utility to follow. Since the regulator is wearing three different professional hats, it is important to examine some of the political variables along with the economic variables that influence the regulatory process.

The first and most publicized political variable is whether a commissioner should be elected or appointed. Only about 11 states, including Georgia, elect their commissioners. The presumed advantage of election is that it promotes responsiveness to the public and not to special-interest groups. Elected commissioners are thought to be more sensitive to their constituency's reaction to possible rates; thus they are expected to offer lower rates to their constituency, and the accountability factor becomes a major issue. To the contrary, it is argued that elections tend to seat commissioners

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

who promise little or no rate increases or have future political desires that can make the regulatory climate unfavorable and heavily pro-consumer. In contrast, an appointed commissioner is expected to devote more time to policy analysis and would be less susceptible to improper rate adjustments that could cause deterioration of services. The contention is that the appointed commissioners would be both pro-consumer and pro-producer. One unfounded fear is that the appointed commissioners would assume the political platform of the governor who appoints them whether their interests lie with the consumer or the producer. The complexity and controversial nature of utility issues minimize the possible gubernatorial influence. Because appointed commissioners have little or no electoral accountability and minimal constituency loyalty, they would implement higher rates than the elected ones.

Hagerman and Ratchford (1978, p. 54) found no statistically significant evidence to support the claim that elected officials offered lower rates of return than appointed ones. (It is generally assumed that lower rates of return for the utility translate into lower electricity rates for the consumer.) Their study involved numerous economic and political variables. In contrast, Mann and Primeaux (1983, 1986) provide evidence of lower rates for elective officials. They found that residential and industrial rates tended to be higher with appointed commissioners in 1973. Residential rates were ten percent higher and industrial rates were eleven percent higher. All of the remaining categories showed upward pressure on price where there were appointed commissioners, tending to support the overall conclusion that appointed regulators tended to set somewhat higher prices than did elected regulators. The 1979 results were similar to those in 1973. In essence the 1973 and 1979 statistical results confirm a price differential which can be attributed to the commissioner selection method. However, Mann and Primeaux didn't conclude that commissioners should be elected because of the numerous economic and political variables and the complex issues not included in their statistical analysis.

Although the elected commissioners seem more desirable than appointed ones from the Mann and Primeaux results, two factors support appointment. First, election of commissioners may actually decrease public participation in the regulatory process because the public feels and believes the elected commissioners will act in its best

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

interests. Gormley (1983, p. 17) states, "Less public participation is associated with elected regulators since direct election and public participation are alternative means to a similar end." Also, elected commissioners may engage in pro-consumer rhetoric while not keeping their rate promises to the public because of diminished accountability. The potential welfare gains of lower rates promised by the elected commissioner may not occur.

Second, the appointment process may provide more competent commissioners. The election process creates a commission of people without the required background in finance, accounting, economics, or engineering. Thus, it is reasonable to conclude that the technical expertise of commissioners would be upgraded because the appointed are more educated than the elected. More than 82 percent of the commissioners appointed by the governor have college degrees whereas only 56 percent of the commissioners elected by the people do. Smith (1978, p. 15) reinforces the need for technical expertise when he states, "The days of the layman-regulator seemed numbered in this period of regulatory instability....Likewise, the day of the part-time onlooker, politician and sophist is nearly over." Therefore, since data in favor of elected commissioners are weak and incomplete and the arguments for appointment are strong, the appointment of commissioners is tempting. One way to satisfy reasonably all interests would be a hybrid method of selection. For example, an elected commission like the GPSC would be replaced by a commission appointed by the governor, approved by the legislature, and selected by a special panel with representation from utility, public, and government interests.

The second variable is the commissioners' length of term. Experts opine that the longer the term, the more likely utility rates will increase, and the shorter the term, the more likely utility rates will decrease. The lower rates occur because the commission feels the public and political pressure, whereas higher rates occur because the commissioner becomes insulated and isolated from the same pressure. The longer the commissioner stays in office, the greater the chance his ties with the utility will mature and develop. Howe and Rasmussen (1982, p. 169) explain the following commission life cycle:

> During the first stage, *incipiency*, the commission attempts to

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

> determine the parameters of its mandate, its identity, and thus is not particularly effective. The second phase, *youth*, is characterized by aggressive behavior favoring consumers and by a strong feeling of public responsibility. In the third phase, called *maturity*, commissions lack consumer aggressiveness. There are fewer conflicts with utilities; they work more closely together: procedures are established but regulatory effectiveness has peaked. Commissions are completely inadequate in the final stage, *old age*. They have become close friends with, and speakers for, the utilities they regulate. Commission decisions now run consistently in favor of utilities.

Kamerschen, Kau, and Paul (1982, p. 553) found statistically significant evidence that a long term allows the utility to acquire higher profits while the consumer pays higher electric bills. Their study used electric bills as the dependent variable. Hagerman and Ratchford (1978, p. 54) found data supporting the same claim using the rate of return on equity as the dependent variable. Therefore, commissions should consider having term limitations and length-of-service reductions such as a ten-year non-renewable term or two terms six years long to balance the equity between consumer and producer. The GPSC currently allows six-year renewable terms.

The third political variable is the number of commissioners. There is considerable psychological literature that suggests group decisions tend to be more risky than individual decisions (see e.g. Hagerman and Ratchford, 1978, p. 49). As a result, the larger the commission, the easier it is for the commissioners to shift responsibility for their actions to other members of the group or the group itself. Consequently, larger commissions would provide higher electric rates for consumers. The counterargument is that even with higher rates the collegiality process among the commissioners could promote beneficial results. In contrast, Kamerschen, Kau, and Paul (1982, p. 553) found no evidence that collegiality is beneficial. Their study showed the larger size of the commission corresponds to higher electric utility rates for the consumer. Their evidence revealed that the consumer – specifically the commercial ratepayer – did pay higher electric utility rates. The shifting of responsibility probably creates a more pro-producer than pro-consumer environment.

The fourth political variable is the total budget. First, the larger

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the budget, the more likely it is that the commissioners will exert their influence among the voting public and government, e.g., by assigning jobs to political supporters and by spending on various politically related activities. As a result, they are less influenced by utilities' offering financial and other coercive incentives in exchange for higher rates.

Second, the larger the budget, the more likely the commission's staff has adequate resources. An underfunded commission encounters difficulty in monitoring firm performance and evaluating rate increase requests. A small budget relative to the state's size is likely to slow the process. Consequently, determining the producer's rate of return and the consumer's rate level can encounter regulatory lag for underfunded staffs. Kamerschen, Kau, and Paul (1982, p. 553) found evidence that the total budget has a correlation with competency, expertise and resources of the commission staff. They presumed that an underpaid staff would be less informed and would make poor judgments in favor of the consumer and lower electric bills.

Third, there is evidence to support the relationship between the total budget and the salary of the commissioner. The higher the salary, the larger the incentive for the commissioner to retain his position. The commission would be less likely to raise rates because of the fear that the political majority might replace them. Navarro (1982, p. 128) believes the commissioners' salaries should be upgraded to retain commissioners with professional expertise. He warns that if the expenditures or salaries of the commission are too large, an activist commission with consumer interests might develop and lower rates for consumers would exist. Commissions like the GPSC should be allowed large budgets to meet their requirements, but their expenditures should be monitored to insure efficiency and equity for all interests involved.

Conclusion

At least some of the four political variables affect the rate-making process and influence the rate return and rate level. Also, the regulatory process is inherently a political process where outcomes vary with specific political variables. Commissioners operate in an environment of conflicting interest groups and are subject to the pressure and influence from these groups – the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

producer (utility) and consumer. The aforementioned political variables have important policy implications for the GPSC and other regulators. Navarro (1982, p. 135) believes that convincing evidence exists that elected commissioners, below-average expenditures or lower total budgets, extremely short commissioner terms, and small unqualified commissions lead to an unsatisfactory regulatory climate. The unfavorable climate affects the producer, consumer and regulator and can create a lack of efficiency and equity. Navarro documents that Georgia's regulatory climate was perceived to be unfavorable at least in the 1980s. (See Appendix A.)[3] As a result, in the short run the GPSC's rate-suppressive policies would weaken electric utilities' financial position, leading to delays in capital investments such as the building of new generation facilities. In the long run, the failure to build and meet capacity would cause unreasonable service with potential brownouts and blackouts. Finally, while the ratepayers may benefit in the short run from the rate-suppressive policies, in the long run the regulatory climate can cause higher rates through a higher cost of capital. Both the consumer, who is paying higher rates, and the producer, who may not be covering capital costs even with a higher rate of return, are hurt.

We submit that some kind of regulation, at least in the short run, of the electric utilities is desirable. Although regulation may be needed, it is imperfect and inexact. Nonetheless, we explore the three primary potential alternatives that have been suggested to improve the current situation. The first alternative is government ownership. Many U.S. and foreign local government units operate their own utilities. Moreover, on the national level, France historically owned and operated one of the most efficient and innovative railroads in the world. The advantage would be less inefficiency, but the inefficiencies of bureaucracy inherent in government would outweigh those of the GPSC and other state regulators. Also, government ownership would increase the prospects for large subsidies, but ultimately the taxpayer or consumer would pay for the burden. This is the most unattractive alternative.

The second alternative is complete deregulation of electric

[3] We are unaware of any more recent studies that offer a conflicting opinion. However, that Georgia was the first state to deregulate natural gas suggests that the GPSC may now be in the vanguard.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

generation, such as is apparently emerging in airlines, telecommunications and trucking. Since the 1930's, electric utilities have been regulated by the states they serve. As a result, electricity prices vary widely from state to state, with customers in the Pacific Northwest paying, in some cases, one-third the rates of consumers in the Northeast. Complete deregulation seems attractive because there are few real natural monopolies today because of technology changes and because in many cases government regulation has reduced, not increased, competition. The advantage would be in a market or competitive approach to the generation sector. Transmission and distribution would still have some regulatory control. The hope would be increased plant efficiency and lower electric rates with a reasonable rate of return for the firm. Congress passed the Energy Policy Act in 1992 that required all electric utilities to share their transmission lines. California began to allow utility customers to buy electricity from any supplier of their choosing in 1998. This put pressure on at least 25 states, including New York, New Jersey, Pennsylvania, Massachusetts and New Hampshire, that were also in the process of deregulating their utility markets. Some opine that the restructuring of the electric power industry could slash electricity bills by from 15 to 50 percent if the national surge in power company mergers does not limit the price decreases. The dangers of this approach are evidenced in a recent NARUC speech by Secretary of Energy Bill Richardson who claims there is "strong evidence" that some utilities are using near-monopoly power to raise electric rates far above competitive levels and are delaying legislation that would give regulators more power to curb anticompetitive practices. (See Failka, 2000.) For example, drawing on a Stanford University study, Mr. Richardson said that utilities in the U.S.'s first deregulated electricity market in California used market power to raise prices $800 million above competitive levels in the summers of 1998 and 1999 and concluded that federal antitrust laws and new competitors might not be sufficient to bring prices down soon. Nonetheless, this alternative of complete deregulation offers the second most promising alternative.

The third alternative is reorganized commission regulation coupled with partial or semi-deregulation. When feasible, optimal regulation can reduce or eliminate market inefficiencies and enhance social welfare. But there are many problems with regulation,

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

including limited information, uncertainty, human frailties, and institutional weaknesses. It is hard to collect and analyze all the data necessary to regulate an industry. The firms guaranteed a specified rate of return lack incentives to be efficient and have a tendency to build more capital than they need. It may give rise to excessive nonprice competition. Possible reform alternatives should include larger total budgets, appointment through multi-interest participation, longer non-renewable terms, and an adequate number of commissioners and staff with professional expertise. The reforms should also encourage regulators to continue to move away from inefficient rate-of-return regulation which have prevailed in the U.S. Commissioners' reorganization with semi-deregulation is in our view the best alternative in the current regulatory climate. Under this alternative the producer and the consumer might see more harmony between equity and efficiency. That is, we believe this alternative provides the best blend of the economic (i.e., private efficiency), political (i.e., governmental power), and social (i.e., private equity or fairness) factors. With these various refinements, the consumer might receive reasonable rates and adequate service, the producer might receive fair rates of return and timely capital investment while operating efficiently, and the regulator might receive praise for his balancing job combining efficiency and equity (what a rarity).[4] As Gormley states (1983, p. 68), "A public utility commissioner today is about as popular as a baseball umpire. At best, he is taken for granted; at worst, he an object of scorn and derision." Although the trend is definitely away from regulation and toward competition, regulatory commissions are still firmly in control in most state electric utility markets. While regulation has never been optimal, suboptimal regulation has helped in many markets. The danger in the alternative of relying exclusively on "letting markets work" is that markets, like regulation, are often also imperfect and nonoptimal.

[4] As an example of what can be done, consider the imaginative electric pricing that is developing in some states. (See Kamerschen, forthcoming 2000.)

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

References

Baumol, William J., "On the Proper Tests for a Natural Monopoly in a Multiproduct Industry," *American Economic Review*, December 1977, *67*, 809-822.

Berg, Sanford V., and John Tschirhart, *Natural Monopoly Regulation*, New York: Cambridge University Press, 1988.

Bonbright, James C., Albert L. Danielsen, and David R. Kamerschen, *Principles of Public Utility Rates*, Arlington, Virginia: Public Utilities Reports, Inc., 1988.

Carlton, Dennis W., and Jeffrey M. Perloff, *Modern Industrial Organization*, Third Edition, New York: Addison-Wesley, 2000.

Church, Jeffery, and Roger Ware, *Industrial Organization: A Strategic Approach*, Boston: Irwin McGraw-Hill, 2000.

Denning, Mike A., and Walter J. Mead, "Competition in Electricity: New Markets and New Structures," *Public Utilities Reports Inc.*, Spring 1990, *8*, 21-39.

Failka, John J., "Energy Secretary Says He Has Evidence Some Utilities Use Monopoly Tactics," *Wall Street Journal*, March 6, 2000, A4.

Gormley, William T., *The Politics of Public Utility Regulation*, Pittsburgh, Pennsylvania: University of Pittsburgh Press, 1983.

Hagerman, Robert L., and Brian T. Ratchford, "Some Determinants of Allowed Rates of Return on Equity to Electric Utilities," *The Bell Journal of Economics*, Spring 1978, *9*, 46-55.

Hall, John, "Are Rates Charged by Government-Owned Utilities Too Low?" *Public Utilities Fortnightly*, 4 August 1983, *112*, 37-39.

Howe, Keith M., and Eugene F. Rasmussen, *Public Utility Economics and Finance*, Englewood Cliffs, New Jersey: Prentice Hall Inc., 1982.

Kahn, Alfred E., *The Economics of Regulation: Principles and Institutions, Vol. I and Vol. II*, New York: Wiley, 1971.

Kamerschen, David R., "Pricing Developments in Electricity Utility Industry," *American Business Review*, Vol. X, No. X (Forthcoming, January 2001), pp.

Kamerschen, David R., James B. Kau, and Chris W. Paul, "Political Determinants of Rates in Electric Utilities," *Policy Studies Review*, February 1982, *1*, 546-556.

Mann, Patrick C., and Walter J. Primeaux, "The Controversial Question of Commissioner Selection," *Public Utilities Fortnightly*, 17 March 1983, *111*, 21-24.

Mann, Patrick C., and Walter J. Primeaux, "Regulator Selection Methods and Electricity Prices," *Land Economics*, February 1986, *62*, 1-13.

National Association of Regulatory Utility Commissioners (NARUC), *Annual Report on Utility and Carrier Regulation*, Washington, D.C.: 1989.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Navarro, Peter, "Public Utility Commission Regulation: Performance, Determinants, and Energy Policy Impacts," *The Energy Journal*, April 1982, *3*, 119-139.

Patrick, Robert H., and F.A. Wolack, *Estimating the Customer-Level Demand for Electricity Under Real-Time Market Prices*, Mimeo, Rutgers University, 1997.

Phillips, Charles F., *The Regulation of Public Utilities*, Arlington, Virginia: Public Utilities Reports, Inc., 1988.

Smith, Lincoln, "State Utility Commissions –1978," *Public Utilities Fortnightly*, 16 February 1978, *101*, 9-15.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Appendix A Table 1. State Ratings of Regulatory Climate

VERY FAVORABLE	FAVORABLE	UNFAVORABLE
Arizona	Arkansas	Alabama
Florida	Colorado	California
Hawaii	District of Columbia	Connecticut
Indiana	Idaho	Georgia
New Mexico	Illinois	Iowa
North Carolina	Kansas	Louisiana
Texas	Maryland	Maine
Utah	Michigan	Massachusetts
Wisconsin	Minnesota	Mississippi
	Nevada	Missouri
	New Hampshire	Montana
	New Jersey	North Dakota
	New York	Rhode Island
	Ohio	South Dakota
	Oklahoma	West Virginia
	Oregon	
	Pennsylvania	
	South Carolina	
	Vermont	
	Virginia	
	Washington	
	Wyoming	

Source: Navarro (1982, p. 130).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Ecology and Evolution

Editor: Roger Pearson

Chap. 1. Ecology, Adaptation and Speciation
Roger Pearson

Chap. 2. Ecosystem and Genetic System
F. J. Irsigler

Chap. 3. Mammalian Societies and the Emergence of the Family System
J. W. Jamieson

Chap. 4. Understanding Human Evolution: Kinship *versus* Social Materialism
Roger Pearson

Chap. 5. Genetic Altruism: Some Hypotheses on Monogamy, Polygyny, Incest Taboo, Exogamy and the Origins of the Family
Umberto Melotti

Chap. 6. Ethics and the Social Sciences
Raymond B. Cattell

92 Pages – Extensive Bibliography – ISBN 0-941694-00-3
$15.00 (add $2.50 postage) M/C-Visa Accepted

Institute for the Study of Man
1133 13th St. NW., Suite C-2, Washington DC 20005
Tel: (202) 371-2700 Fax: (202) 371-1523

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Illusions vs. Perversity: "Multiculturalism" and the Prospects for Democracy

Miles D. Wolpin[1]
State University of New York
Potsdam, New York

Rhetorical slogans explain much of multiculturalism's appeal to the uninitiated. The movement's dynamic thrust, driven by radical deconstructionists, is increasingly antithetical to its liberal ideological symbolism. Both the illusory premises of the latter and the Hobbesian implications of deconstructionist dominance are assessed. A contrasting societal paradigm represented by an emergent socio-cultural conservative movement is elaborated. Whether "democracy" can survive this intensifying "culture war" is questionable.

Key Words: Multiculturalism, socio-cultural conservatism, deconstructionism, social division, ideological inversions, neo-conservatism, Balkanization, Liberal inconsistencies.

Ideological Sources of Symbolic Appeal

The question was well-framed by Natasha, a recently naturalized American, "How can any well-intentioned person be critical of 'multiculturalism' or immigration? Aren't we a "nation of immigrants?"" Like "democracy," "freedom," and perhaps "the family," multiculturalism as "diversity" has assumed a salient place in elite American ideological rhetoric.

Why then do many American citizens react skeptically to a concept that appears so broad?[2] Indeed, many groups in Europe, Asia and elsehere have adopted identity-based communitarianism to reinforce nationalist programs. Such partly racially-based cultural defense movements are in many countries broadening their

---

[1] I wish gratefully to acknowledge Jackie Rush's assistance in preparing the manuscript.

[2] Historically, the primary attachment of socio-cultural conservatives was to the values and leadership of the aristocracy and/or social upper class. During the past century this reference group has been attenuated in favor of the dominant national culture and traditional institutions within a state.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

constituencies among more traditional lower-middle, working class and rural constituencies.[3]

Although many left-of-center parties are experiencing such desertions by traditional supporters to the "nativist" right, it affronts their "tolerance" to seriously consider ideas articulated by even moderate conservatives. Indeed, numerous Liberals have themselves during the past century joined Marxists in displaying a chauvinistic disdain for the intellectual perspicacity of their more conservative opponents. This despite the costliness, bureaucratic weight and spotty record of success for many of their own pet programs.

Notwithstanding such Liberal hubris and disrespect for conservative social theorists, the latter have in recent years generated serious empirical and evaluative critiques of various statist social-engineering schemes as well as of the "multiculturalist" variant.[4] While multiculturalist tenents obviously provide a way of ordering as well as ascribing meaning to socio-political phenomena and prescribing norms for behavior, like the content of other modern ideologies they ultimately rest upon problematic beliefs that often distort Liberal perceptions.

Multicultural activism generally contravenes both abstract Liberal symbols and ubiquitous regularities of normal human behavior. Indeed, moderate conservatives regard "multiculturalist" policies as self-defeating in terms of outcomes, as well as inimical to merit-based "social justice." Even worse, multiculturalist policies intensify social distrust as well as undermine the rule of law, civility, and the very foundations of even an imperfectly democratic social order.

These pernicious consequences flow for the most part *not* from

---

[3] Richmond (1994); Wrench and Solomos (1995); Leslie (1995); Lewis (1996); Papademetriou and Hamilton (1996); Wicker (1997); Cate (1997); Braun and Scheinberg 1997); Pasture and Verbarckmoes (1998).

[4] Some pertinent works which in varying degree inspire this discussion, include: Beck (1996); Brimelow (1995); Bernstein (1994); Buchanan (1997); Casement (1996); Codevilla (1997); D'Sonza (1992); (1995); Farrell (1994); Fallon (1998); Fischer (1989); Fox-Genovese (1995); Francis (1998); Gross (1997); Hamilton (1997); Hoff-Sommers (1994); Huntington (1997); Immigration (1995); Jatras (1998); Lefkowitz (1996); Levin (1997); Lynch (1992); O'Sullivan (1998); Richburg (1997); Richert (1998); Rushton (1995); Siegel (1997); Sowell (1995); (1996); (1996a); Thibodaux (1994); Thernstrom (1997); Weissberg (1998); West (1997).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the liberal internationalist or humanitarian beliefs that are founded upon the universalist pretensions of most elite sympathizers. The symbolic appeals to "equal rights," "respect for diversity," "inclusiveness," "fulfillment of democracy," etc., are integral to this *nominal* ideology, which is inspired by the liberal and in varying degree therapeutic as well as social democratic traditions.

Their advocacy by well-intentioned and frequently guilt-prone Liberals not only gives the movement an aura of ideological legitimacy, but obscures a symbiotic dependency of this institutional elite stratum upon radical cadres whose neo-Marxian and Nietzchean inspiration account for a militantly confrontational zero-sum operational paradigm. Thus, there is a disconnect between the liberal rhetoric and the totalitarian methods the multiculturalists use. In emphasizing such a "two-faced" dimension, one prescient analyst (Francis, 1998: 32-33) stresses the use by this militant radical "inner circle" of the liberal legitimating symbols to mask a revolutionary deconstruction of commonly held national symbols, identity and institutions.[5] A cultural war follows that is unconstrained by humility, moral scruples or such "Eurocentric" values as tolerance and "the rule of law."

What is it then that binds humanitarian Liberals to the envy-prone power-obsessed gender or ethno/racial particularists who are the driving force of the movement as well as the source of most of its repressively intolerant destructive tendencies? Clearly the

---

[5] "One face tells us that American society is imbued with exclusionary and repressive pathologies and calls for the extirpation of the basic mechanisms by which the pathologies and repression are sustained; the means to extirpate them is the enhancement of 'diversity' and the challenging of the dominant institutional categories that in effect define the social order. The other face denies any such goal and assures us that diversity is no threat at all. Pointing to this contradiction is important, not so much to expose and refute the muddled thinking of the multiculturalist mafia, but rather to make clear the tactics by which this mafia seeks power. . . . the other face of multiculturalism mobilizes its revolutionary agenda by using commonly accepted words and icons of the contemporary dominant culture—'democracy' and the 'global society,' not to mention the ubiquitous clichés that 'America is a nation of immigrants' or the 'first universal nation' or is 'founded on a proposition' too abstract to permit real cultural content. It uses these words and icons in order to gain a sympathetic hearing from the commonplace centers of cultural power. This suggests that multiculturalism is as powerful as it is because the groundwork for its revolutionary attack on traditional American culture has been laid for it by the contemporary dominant [Liberal] culture . . ."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

militants depend upon the Liberals to influence the policy process within the semi-secular "religious," educational and media establishments as well as the Executive and Judiciary. They have as yet had somewhat less success with the more democratic referenda and legislative institutions.

Liberal elite deference to the militants may be explained by a mixture of guilt, compassion and illusory misperception of radical goals which are masked by Liberal rhetoric. Not particularly courageous in most instances, Liberals are frequently intimidated by the envious (Wheeler, 1998:6), who are prone to denounce them for alleged hypocrisy.[6] Few such *de facto* "fellow travelers" are disposed to expose themselves to racist, sexist or homophobic labeling! Careers, even of dissenting members of "victim" groups, are thus easily destroyed.[7]

Reinforcing their propensity to "be reasonable," is the absence of attacks upon the indirect links of the multicultural movement to corporate wealth. The stress on "Race, gender and class" is generally operationalized in a manner that tacitly de-emphasizes the last. That

---

[6] "The Liberal strategy is to apologize for success in order to appease the envious. *Liberalism is thus not a political ideology or set of beliefs. It is an envy-deflection device, a psychological strategy to avoid being envied.*

The more one fears being envied, the more one is driven to self-humiliation in attempts at envy-appeasement. This masochism becomes socially and politically destructive when it is projected onto the various social or tribal collectives to which the liberal belongs and are a part of his self-identity. Self-loathing is transformed into a loathing for one's society or race. White male liberals become *auto-racist* and *auto-sexist*: racists towards their own race, sexists towards their own sex. Penny-ante demagogues like eco-fascist environmentalists, feminazis, animal and homosexual rights types, get their strength from the liberal's fear of their Evil Eyes. As the Amazon tribeswoman who says her baby is ugly, so the white male liberal says his gender, his race, his country, his civilization, and even his entire species is ugly."

[7] Although many such examples can be found in Bernstein (1965) and other works referred to in note 3, as well as AIA's monthly *Campus Report*, such fears in all probability affect only a small minority who become doubters. Not only do most members of the Liberal intelligentsia misperceive (or rationalize) militant operationalization as conforming to their own neutral symbols and related illusory beliefs, but some analysts (O'Sullivan, 1998:23) regard their general pattern of interactive unity (with radicals) as sufficient to treat them as a hegemonic bureaucratically-based "new class." Hence, "the non-technical 'intelligentsia' which controls the bureaucracy, the courts, federal agencies, the media, and cultural institutions. This class is united not only by common interests but also—and more importantly—by a common concept of those interests. In everyday life, these are the imperatives of liberal politics."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

may also explain why much of the corporate elite initially failed for the most part to oppose the movement. Indeed some of their foundations and corporations have funded militant group preference advocacy.

Other factors conditioning the softness of the transnational corporate sector responses include the globalist institution-building and anti-nationalist ideological perspective of international capital – which represents the dominant tendency in the ex-liberal "neo-conservative" sector. For different reasons, medium- and some small-business sectors have been inhibited by their own desire to exploit lower-cost illegal alien and immigrant labor, which has depressed (Briggs, 1998) wages, working conditions, and the potential for trade union organizing.

While neither of these corporate sectors are, properly speaking, in the Liberal camp, both have supported certain reinforcing "multiculturalist" policies (e.g., permissive immigration, "diversity"), largely for perceived bottom-line reasons. In contrast, although upper middle class careers are often highly contingent upon lockstep ideological conformity, they are also more likely to have at least lightly internalized the *nominal* Liberal "face" of multiculturalist ideology itself, or at least some of its assumptions.

Problematic Assumptions of the Liberal Paradigm

Perhaps the most fundamental illusion is that "affirmative action" group preferences and repressive intolerance can be reconciled with a tradition of due process premised upon *individual* rights and equal protection of the law. Indeed the common law evolved as a means of attenuating group exemptions or privileges in favor of equal individual rights, as well as of gaining uniform enforcement against all groups. Judicial neutrality and the very essence of liberal conceptions of procedural justice have been symbolized by the blindfold. Multiculturalist rejection of this traditional expectation in court trials and administrative hearings (D'Souza, 1992; Bernstein, 1994) has generated intense citizen alienation toward the judiciary and bureaucratic state.

A second illusion is that systematic official redistribution of group opportunities and/or benefits by the state according to ascriptive or other "disadvantaged" criteria which ignore, and even subvert, the principle of individual merit – one of the historic sources

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

of liberal appeal – will not further intensify citizen alienation toward government *per se*. Here the laws *substantively* contravene equal opportunity norms. By failing to proportionately reward superior performance, such policies further undermine (Codevilla, 1997) personal responsibility and the work ethic – traditional liberal values as well as diminish productive economic incentives.

Unsurprisingly, the responsible elites are not only increasingly estranged, both in terms of lifestyle and morality, from ordinary citizens, but as Lasch (1995) stresses, they are also prone to chauvinistically disdain "Joe six-pack's" traditional liberal ("conservative") values, human dignity, family and religious beliefs. These have become prime targets for Liberal state intervention to alter values and norms. So much for "diversity." Consequently, barely 10% of American union members in one recent survey identified themselves as "Liberals."

A third illusion is that growing state intrusiveness (i.e., behavioral regulation) in *primary* as well as secondary social relationships is consonant with meaningful liberty, let alone with a democratic polity. It is not coincidental that the major *catalyst* for such "social engineering" has been bureaucratic and judicial in origin. Repeated survey research findings that broad citizen majorities oppose speech codes, permissive immigration, and special rights for "victim" groups (e.g., harassment, criminal, housing, employment, educational) are simply disregarded by Liberal and "moderate" elites alike. Hence, there is a growing emphasis upon state coercion against "insensitive" speech, guns, white (Fallon, 1998: 56-58) "hate" (or thought) crimes, and reactive movements of the alienated.

If the foregoing tendencies contravene the liberal ideal, the same can be said of "multiculturalism's" new operationalization (Bernstein, 1994; Weissberg, 1998) of tolerance. A core value, like free speech, implies the absence of sanctions against expressive "diversity." Thus, a fourth illusion of such social constructionists is that politically correct linguistic inversions can be imposed – particularly when the traditional value of tolerance has not been widely or deeply internalized.

Now it is operationalized to mean romanticizing and even *celebration* of "victim" groups that one may not in fact hold in high regard. Such "tolerance," of course, *does not preclude* ubiquitous negative stereotyping or "insensitive" hate rhetoric directed at

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

"oppressor" groups. As in totalitarian systems, this engenders not only resentment, distrust and alienation, but public deception coupled with *sub rosa* defiance. It asphyxiates "free" civic or educational discourse, as well as the civility that is essential to any genuinely democratic process. Would John Stuart Mill turn over in his grave? But then he is *just* a "Dead White European Male."

A final illusion weakening "post-modern" Liberalism pertains to the universalist principle that diversity *per se*, in a national as well as an international setting, can generate greater affect and normative priority than identification with one's own membership or reference group.[8] Or that equal respect, let alone affect, will be accorded to all of the many "others'" groups. That such rhetoric is sharply at

---

[8] Thus, O'Sullivan (1998:21-22) maintains that the American nation has been arbitrarily alleged by Liberals to represent nothing more than a "creed" premised upon liberal principles including "diversity." Denuded of its historic ethnic and socio-cultural basis, this formulation whose plausibility is reinforced by massive less assimilated immigration of Third World peoples, is promoting de facto separatism and long term attenuation of the European liberal values that are said to provide meaning and unity to the American nation. "In short, the theory of America as an idea is a Trojan horse concealing the concept of a multiculturalist America. If Americans are united not by a sense of common nationhood and a common culture but merely by liberal political ideas, then there is no reason why American culture should be privileged as the culture of the entire people. It would merely be the culture, language, customs, etc., of one ethnic group—one ethnic group among many competing for attention and respect in the public square. And all that would be required of another ethnic culture seeking equal recognition in schools, the voting booth, and the workplace would be that it conform broadly to the liberal political ideas of the Declaration.

But what would happen to American ideas in the process? You cannot sever philosophy from its surrounding culture and expect it to develop along the lines of that culture. The ideas of liberty and equality in the Declaration of Independence were the distilled essence of a much broader and richer culture including songs, stories, poems, customs, folkways, shared historical experience, and the mystic chords of memory. Americans who had no interest in political ideas as such were nonetheless shaped by that culture—by the lived experience of a free life—into a different sort of people from the inhabitants of closed, traditional, or despotic societies. . . .

All this would change in a political environment of multiculturalism. Liberal ideas would be increasingly deprived of the cultural soil in which they grew and which gave them meaning in political debate, court decisions, and local customs. They would develop new meanings, sometimes radically at odds with their old ones. They would be increasingly defined by the courts so as to reconcile them with new versions of common sense —namely, that all cultures have equal status except when one clashes with feminism, or that separation of church and state means separation of religion and society, or that political equality means different rights for different classes of people.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

odds with Liberals' own selective (i.e., arbitrary) application of their Euro-American (i.e., Western) "principles" should be an occasion for humility. Its historical and cross-cultural empirical basis (Sowell, 1996) is as weak as the operational primitive ancestral blood-guilt "justice" criterion. The latter is being used to demand compnesatory entitlements.

Even worse, the contemporary "multiculturalist" victimization paradigm is wholly dysfunctional from a societal perspective, since it paternalistically stigmatizes minority achievers while simultaneously vitiating both personal responsibility as well as the work ethic among "victim" groups. Beyond these concerns, certain high-performing minorities such as the Japanese, Indians and Arabs are excluded from special concern, while selected Western values are employed to denounce aspects of Third World (Islamic, Asian and African) cultures! So much for equal respect and "tolerance" for diversity even among self-styled Liberals.

The Operational Paradigm: Contradictions and Implications

It may be inadvertent or willful ignorance of the illusory and contradictory nature of liberal multiculturalist universalism that explains much of the ideology's symbolic resonance *vis a vis* those within or at the fringes of the Liberal (or Social-Democratic) intelligentsia. This relatively privileged minority stratum – dominant in the public sector, media and universities – is in varying degree idealistic, and regards itself as the most "compassionate" sector in society.

When some experience a sense of growing disillusionment, it is not usually because of cognizance that their Liberal internationalist (multiculturalist) ideals are inherently utopian. Nor is it simply because of the Machiavellian "Realism" of the radical militants who underscore the power dimension.

As implied in preceding sections, "multiculturalism's" operational dynamic involves a fundamental contradiction (Smith, 1997) between cultural relativism and distrust-premised extreme deconstructionism. While the former Liberal tendency denies significant differences between what has traditionally been venerated and its antithesis, extremists emphasize denunciation of traditional society or culture and rejection of any legal *restraints* applicable to morally superior "victim" groups. Such double standards vitiate both

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the rule of law and Constitutionalism itself.

Thus the increasingly dominant radical policy thrust portrays the American heritage almost exclusively as that of an oppressor nation *vis a vis* women and indigenous non-white and Third World "victims," who in turn are romanticized.[9] Patriarchy and its key institution, the family, are similarly vilified. Similar tendencies are apparent within the militant lesbian and homosexual sectors with respect to heterosexuality. As Francis (1998: 32-33) stresses, to "overthrow the culture" of oppression, radical multiculturalists endeavor to destroy or neuter the institutions that carry it.

Infusing this deconstructionist vilification of Euro-American civilization is a determined drive to maximize the power of militant counterelites who – driven by self-righteous envy – purport to represent the presumably single-minded victim groups. Hence radical (racist?) Hispanic and Black interest group "leaders" ferociously oppose immigration control because the current permissive policy is shifting their demographic power base against white Euro-Americans. This is despite the fact that a huge majority of Black Americans, as well as a substantial percentage of Hispanics and Asians, not only favor restriction, but are among the primary losers (Briggs, 1998) to unskilled immigrant job seekers.

In contrast to the traditional liberal emphasis upon equal protection and the rule of law in a context of individual rights and "due process," the multicultural militants view law itself as *merely instrumental* to gender or ethnic domination and "oppression." Thus, law is not an object of respect *per se*, but a means to reversing the power equation through politicized juridical and bureaucratic fiat. If the latter can generate group exemptions or preferences ("reverse discrimination") for "victim" groups that may variously hold minority or even majority status, so much the better!

If blacks articulate substantial disagreement, they are even more violently labeled and denounced (than whites) for deviating from "the black view." Similar "tolerance" (a Euro-American value?) extends to dissidents within the Hispanic and variously gendered anti-heterosexuals. Similarly, anti-white or male remarks or hate

[9] As McDougall (1997) implies in his critique, this deconstructionist obsession even infuses the newly proposed "National Standards for History."

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

crimes by members of "victim" groups are excluded from definitions of "racism" and "sexism." And such violence by the "oppressed" is invariably justified as resistance to "social injustice." Hence, societal trust and civility have been attenuated to the point that respectful dialogues between opposed groups have now become a civic rarity. Indeed, *ad hominem* attacks and denigratory labeling of those eschewing politically incorrect views are the norm.

This reductionistic paradigm bares a striking if imperfect resemblance to the Marxian model of class conflict. The latter ordains not only direct group struggle but equally a *determined effort* by the proletarian vanguard to eradicate traditional bourgeois cultural values, beliefs and attitudes; i.e., the "superstructure." Thus, there is a zealous no-holds barred neo-Gramscian assault and effort radically to transform all civil socializing institutions infused by customary values – education, judicial, family, religious, etc.

Hence, rhetoric and slogans are systematically employed to mask a grossly distorted Manichean portrayal of traditional institutions and Western values. This radical deconstructionist obsession denies them any positive contribution. Nor does it admit the possibility that relationships between sexes, races, or even to some extent classes, may be based on differences in natural attributes, and are therefore complementary. The simplistic and utterly ridiculous (Sowell, 1996a; Pearson, 1996) underlying assumption is that only oppression can explain social inequality. And as Farrell (1994) and Hoff-Sommers (1994) demonstrate with respect to sex differences, residual inequalities are both greatly exaggerated and flow from sources having little to do with oppression.

For reasons alluded to in the preceding section, disenchanted Liberals become quasi-captive fellow travelers. Despite growing doubts among the more perceptive and intelligent about deconstructionist fanaticism, fear of "racist" or "sexist" labeling and career jeopardy deters most from even articulating objections. For some, then, intolerance precludes intellectual "diversity." Yet others, particularly the less accomplished and/or intellectually astute, cannot perceive that their own ideological liberal principles contradict the ubiquitous operational practice by militant deconstructionists.

Indeed, when addressing Liberal audiences and attentive publics, these less astute individuals almost invariably endeavor to mask group preferences and power-seeking in liberal or "globalist"

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

symbolic rhetoric. Many even misperceive the ultimate goals as egalitarian rather than as a new tribalism premised upon quasi-primordial particularist group loyalty and a Nietzchean quest for hegemonic power.

Hence the "backlash" is usually misperceived as little more than "racist" and "sexist" hostility to a more egalitarian and "socially just" society premised upon "diversity" and "tolerance." But isn't perceptual distortion an attribute of even *ad hoc* ideologies? The mere suggestion that the status of particularist groups may not be largely (Rushton, 1995; Henry, 1995; Sowell, 1996) a consequence of discriminatory oppression is rejected out of hand as a matter of faith rather than being considered as something "open" to consideration or respectful "civil" discourse and debate.

Conservative Dilemmas and Nuances

Despite incisive critiques of the foregoing tendencies and the consequential civic decay, relatively few ideological Liberals or radicals have been persuaded to join the opposing "conservative" movement. The latter has experienced somewhat greater success among lower middle and working class sectors, whose (Codevilla, 1997) values, heritage, institutions and equal opportunities have been impugned. Although this has been particularly true of religious believers, whites and males, it also extends in some measure to an appreciable portion of "oppressed" groups.[10]

Clearly there is a *marked division* between "free trade" neo-conservatives (i.e., "moderates") associated with international capital, and the socio-cultural nationalistic tendency within the movement. Although growing in influence along with often-allied religious and "patriotic" constituencies, this sector is far from hegemonic.

Thus far, the dominant "free trade" globalists have preferred to govern coalitionally with Social Democratic or welfare state Liberals.

---

[10] A substantial percentage of women vote Republican, against group preferences and bilingualism, while a majority eschew the "feminist" label. Similarly, "school choice" is popular among Blacks as is immigration control. Among the "Promise Keepers," there is a proportionate Black presence. Even among Hispanics, many oppose bilingual education, group preferences and uncontrolled immigration. Asians are even more conservative on most of these issues.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

What has undergirded the viability of this uneasy alliance, aside from their mutual disenchantment with nationalism, has been the latter's willingness to retrench welfare state largesse and the former's disposition to acquiesce in limited Liberal multiculturalism. Liberal support for greater international room for maneuver for global capital has further reinforced the coalition. Yet enhanced capital mobility and freer trade have intensified the "fiscal crisis" (Teeple, 1995; Buchanan, 1997) contributing to entitlement and other welfare state program erosion.

While one might legitimately question whether international capital can be properly classified as "conservative," certain ascriptive upper class socio-economic characteristics, along with its opposition to populist regulation or state redistributionist policies, provide some basis for such a characterization. During the past half century, big capital has generally supported parties or factions on the right. Thus, such OECD area *de facto* coalitions function only because of a rightward economic and fiscal policy shift (Teeple, 1995) by Social-Democratic and other "left" parties.

As radical group preference advocates become even more dominant and militant in the multicultural movement, we should expect corporate disenchantment to intensify. This will be for two reasons. One is unparalleled global competitiveness, which puts a premium upon efficiency. The latter is incompatible with hiring or promoting on the basis of proportional quotas for various racial, ethnic or gender categories, including now even the disabled.

This not only conflicts with such a criterion as individual performance merit, but it subordinates property rights while progressively enhancing group rivalry and tensions in the workplace. Managers also become fearful of passing over or disciplining members of "protected" groups with special rights against perceived harassment and discrimination.

The foregoing new norms have wrought havoc with due process and its traditional presumption of innocence. There are also skyrocketing costs associated with a litigation explosion. Other corporate burdens have resulted from the prophylactic need for costly new "sensitivity" indoctrination and "diversity" bureaucratic accretions. Predictably, a plethora of often unfounded complaints and litigation has resulted.

Of almost equal importance, the transnational corporation

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

requires law, and particularly order, to function cost-effectively. Deconstructionist radicalism intensifies ascribed importance to pre-existing group differences, and exacerbates animosity-heightening distrust. Sowell (1996) contends that power and privilege-seeking militants often create new violence-prone tensions where none existed before. This, in turn, often engenders social distrust and fragmentation in the workplace, localities and the state itself.

While ethnic and/or religious violence is already endemic and rising in the South, it is also becoming increasingly common in the East. Even within the OECD, racial and ethnic violence is being advocated by multicultural militants as well as by the growing (Braun and Scheinberg, 1997) patriotic and other sectors of the "extreme right."

Not only is this "bad for business," but its likely consequences – separatism and Balkanization – can only increase the costs of adapting to a multiplicity of jurisdictions and even mini-states. Neither a huge diversity in regulations nor currencies or, for that matter, fragmented markets serve the interests of corporate globalism.[11]

Despite the foregoing tendencies, an alternative coalition in the future with socio-cultural conservatives would also be marked by serious tensions. Although like the neo-conservative corporate sector they too at times pay homage to universalist norms – especially in opposition to radical deconstructionist group preferences – in practice socio-cultural conservatives are equally prone to particularist loyalties.[12] The problem is that theirs is a radically divergent frame of reference.

While they agree with neo-conservative sectors on both the need for order, greater individual responsibility, and retrenching antithetical welfare state entitlements, socio-cultural conservatives

---

[11] Although internationalists of both the multiculturalist left as well as the "libertarian" or neo-conservative corporate right assume that international institutions will progressively replace states with global governance, this too will be gradually recognized as an illusion. For if the nation-state is encountering a growing "crisis of governance," how can one expect more remote, unaccountable and heterogeneous regional or global institutions to be more successful?

[12] This in terms of the nation state and its predominant culture as well as, in some instances, Western civilization. Conservatives differ as to the universalistic potential of the latter.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

place high priority upon patriotic loyalty to their nation state, its heritage and the well-being of lower middle and blue collar sectors. Common language, ethnic communitarianism, traditional religious and cultural values, in conjunction with pride in the nation's achievements, sharply distinguish them from both corporate neo-conservatives and Liberals, and especially from secular radical multiculturalists.

So does their rejection of aggressive internationalism, which they equate (Bandow, 1998) with neo-imperialist interventionism. Whether effectuated under the guise of *imposing* "democracy" or radical secular Western conceptions of "human rights," socio-cultural conservatives recoil from such rationales for utopian globalist meddling and intrusiveness, as well as the wasteful expenditure of American lives and resources.[13]

Ultimately they regard these tendencies as integral to an incremental process (Jatras, 1998) of subordinating the sovereignty of one's own nation-state to globalist institutions that are dominated by the extant elite coalition of pro-corporate neo-conservative (ex-liberals) and Liberal internationalists. Linked to "free trade" and an "open door" for speculative capital as well as for immigrants, this process is regarded as a clear and present danger (Buchanan, 1997) to national identity and well-being.

Not only is it internally disruptive of societies based upon domestic functional complementarity, and upon reciprocity as well as minimal social trust among classes and ethnic groups, but the globalist project is, in their view, an elite design to enforce a New World Order characterized by nascent world government, transnational corporate dominance and multiculturalism. This New World Order is seen as diametrically at odds with the attitudes and values of the broad majority of ordinary citizens and as something that promises further to erode both the scope of democratic elite accountability and self-governance.

If neo-conservative (or "neo-liberal" to use the Left's term) corporate globalism presents a major and *perhaps* insurmountable (Brooks, 1997) obstacle to future conservative unity, neo-

---

[13] Even some traditional class-oriented leftists (Robinson, 1996) share much of this analysis of "promoting Democracy." The real goal is to promote a global political environment that is deferential to the interests of international capital.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

conservatism's commitment to secularist modernization represents a secondary hurdle. Yet here the fact that Western values (Codevilla, 1997) that highlight property rights and the rule of law have conditioned, and are not invariably antithetical to, our "business civilization" suggests that compromise may be attainable. Nevertheless, the hostility of upscale corporate secularists to traditional religious values remains a major coalitional obstacle.

In the American context, traditional Euro-American values such as the rule of law, thrift, hard productive work, merit (achievement), personal responsibility, family integrity, religious belief, and tolerance are being subverted by radically impulsed multiculturalism. This is being done both directly and through a simultaneous systematic campaign to deconstruct (i.e., transform) major civic socializing institutions such as the family (via state intrusiveness), education (via new "globalist" curricula and therapeutic pedagogy), and the mass media (via multiculturalist bias and censorship).

Deconstruction of the Western (Bernstein, 1994) and American (Fallon, 1998) heritage is regarded by social conservatives as a particularly noxious assault upon not only the common values and language that are integral to national identity, but to the very existence of the nation. This is a disintegrative and alienating process that has proceeded to the point where many are no longer certain what it means to be an American or whether indeed one's national heritage may be regarded as a source of pride.[14]

Conclusion

While socio-cultural conservatives may not have been in the forefront of democratic advance, today they ironically and compassionately represent majoritarian identity and way-of-life concerns that are under assault by cultural radicals and their Liberal institutional facilitators in the media, education and secularized mainline churches. Relying upon plebiscitary referenda and, to a lesser extent, legislatures, such conservatives generally oppose rule by bureaucratic and judicial decrees to impose the culturally radical

[14] Corresponding to this assault (McDougall, 1997) is the double standard applied to the attributes and heritage of "victim" groups where romantic social constructivism replaces deconstructionism.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

agenda upon what remains of local civil society.[15]

If they are unsuccessful, as seems likely, in promoting the emergence of an integrative "new nationalism" (Buchanan, 1998), the denouement may be far from sanguine. While many have noted America's relative decline in the global system, only a few have projected current world trends of polarized separatism, Balkanization and internecine strife (Huntington, 1997; Fallon, 1998) upon the USA by 2050. If American "exceptionalism" is becoming somewhat more problematic, one conclusion emerges with crystal clarity. Multicultural radicals are increasingly successful in attenuating a common heritage, values, language and the rule of law. As the "backlash" – considerably broader than the militia movement – incrementally broadens its constituency, religious and ethnic as well as racial polarization are ever more likely to conjure the prospect of a neo-Hobbesian negative non-zero sum game.

References

Bandow, Doug.
1998. "The New American Century: Searching for Foes in the Post-Cold War Era." *Chronicles*, June, pp. 14-18.

Beck, Roy.
1996. *The Case Against Immigration*. New York: Norton.

Berman, Robert.
1998. "Making Up the Grade: Notes from the Antiveristy." *Academic Questions*, II: 2 (Spring): 38-52.

Bernstein, Richard.
1994. *The Dictatorship of Virtue*. New York: Knopf.

Braun, Aurel and Stephen Scheinberg, eds. 1997. *The Extreme Right: Freedom and Security at Risk*. Boulder, CO: Westview Press.

Briggs, Vernon M. Jr.
1998. "Income Disparity and Unionism: The Workplace Influences of

[15] Yet in defending local and civic autonomy from an increasingly intrusive internationally linked Leviathan State, conservatives have yet to meet the challenge of a lack of compassion toward those vulnerable to poverty or other maladies through no fault of their own. A reformed and residual safety-net welfare state function would seem to be necessary since even tax credits for increased charitable contributions are unlikely to meet such challenges in urbanized mass societies subject to "downsizing" as well as cyclical layoffs/

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Post-1965 Immigration Policy." National Policy Association Conference on the Growth of Income Disparity (1997). Washington, D.C.

Brimelow, Peter.
1995. *Alien Nation*. New York: Random House.

Brooks, David.
1997. "Rich Republicans: Living the Conservative Dream?" *The Weekly Standard*, June 22, p. 18.

Brown, Warren.
1998. "Review: *The Opening of the American Mind: Cannons, Culture, and History*, by Lawrence W. Levine." *Academic Questions*, II:2 (Spring): 88-92.

Buchanan, Patrick J.
1997. *The Great Betrayal*. Boston: MA: Little Brown.
1998. "Toward One Nation, Indivisible: A Course of Action." *Chronicles*, April, pp. 14-19.

Casement, William.
1996. *The Great Canon Controversy*. New Brunswick, NJ: Transaction Books.

Cate, Curtis.
1997. "The Revolt of the French Masses: The Smoldering Fires of Immigration." *Chronicles*, July, pp. 15-19.

Codevilla, Angelo M.
1997. *The Character of Nations*. New York: Basic Books.

D'Souza, Dinish.
1992. *Illiberal Education*. New York: Free Press.
1995. *The End of Racism*. New York: Free Press.

Fallon, Joseph. E.
1998. *Deconstructing America: Immigration, Nationality and Statehood*. Washington, DC: Council for Social and Economic Studies.

Farrell, Warren.
1994. *The Myth of Male Power*. New York: Simon & Schuster.

Fischer, David Hackett.
1989. *Albion's Seed*. New York: Oxford University Press.

Fox-Genovese, Elizabeth.
1995. *Feminism is Not the Story of My Life*. New York: Doubleday.

Francis, Samuel. 1998. "The Other Face of Multiculturalism." *Chronicles*, April, pp. 32-33.

Gross, Martin L.
1997. *The End of Sanity*. New York: Avon Books.

Hamilton, Neil.
1997. *Zealotry and Academic Freedom*. New Brunswick, NJ: Transaction Books.

Hoff-Sommers, Christine.
1994. *Who Stole Feminism*. New York: Simon & Schuster.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Huntington, Samuel.
1997. "The Erosion of American National Interests." *Foreign Affairs.* Vol. 76:5, p. 28.
Iannone, Carol.
1998. "Review: *We Are All Multiculturalists Now*, by Nathan Glazer." *Academic Questions*, II:2 (Spring): 84-88.
1995 *Immigration and the American Identity.* Rockford, ILL: Rockford Institute.
Jatras, James George.
1998. "Rainbow Fascism at Home and Abroad." *Chronicles*, June, pp. 19-22.
Lefkowitz, Mary.
1996. *Not Out of Africa.* New York: Basic Books.
Leslie, John.
1995. *Re-emerging Ethnic Politics in Germany: Far Right Parties and Violence.* Berkeley, CA: University of California Center for German and European Studies.
Levin, Michael.
1997. *Why Race Matters: Race Differences and What They Mean.* Westport, CT: Praeger.
Lewis, Rand C.
1996. *The Neo-Nazis and German Unification.* New York: Praeger.
Lynch, Frederick.
1992. *Invisible Victims: White Males and the Crisis of Affirmative Action.* New York: Praeger.
McDougall, Walter A.
1997. "First Fruits of Those History Standards: Textbook Review." *FPRI Footnotes,* May. Philadelphia, PA: Foreign Policy Research Institute.
"National Research Council Report Confirms Burdens of Immigration."
1997. *FAIR Immigration Report*, June, p. 1.
O'Sullivan, John. 1998. "American Nationalism and Western Civilization." *Chronicles*, July, Pp. 20-25.
Papademetrious, D. and Kimberly A. Hamilton.
1996. *Converging Paths to Restriction.* New York and Washington, DC: Carnegie Endowment for International Peace and the Brookings Institution.
Pasture, Patrick and Johan Verberckmoes.
1998. *Working-Class Internationalism and the Appeal of National Identity: Historical Debates and Current Perspectives on Western Europe.* New York: Berg/New York University Press.
Pearson, Roger.
1997. *Heredity and Humanity.* Washington, DC: Scott-Townsend Publishers.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Richburg, Keith B.
1997. *Out of Africa: A Black Man Confronts Africa*. New York: Basic Books.
Richert, Scott P.
1998. "The Multicultural Lie: The European Roots of American Life." *Chronicles*, April, pp. 20-22.
Richmond, Anthony H.
1994. *Global Apartheid: Refugees, Racism and the New World Order.* New York: Oxford University Press.
Robinson, William I.
1996. *Promoting Polyarchy: Globalization, U. S. Intervention and Hegemony*. New York: Cambridge University Press.
Rushton, J. Philippe.
1995. *Race, Evolution, and Behavior*. New Brunswick NJ: Transaction Publishers.
Siegel, Fred.
1997. *The Future Once Happened Here: New York, D. C., L. A., and the Fate of America's Big Cities*. New York: Free Press.
Smith, Barry.
1997. "What is Post-Modernism?" Lecture at the State University of New York College, Potsdam, March.
Sowell, Thomas.
1995. *Race and Culture.* New York: Basic Books.
1996. "'Affirmative Action': A Worldwide Disaster." In *The Essential Neo-Conservative Reader.* Mark Gerson, ed. Reading, PA: Addison-Wesley. Pp. 236-82. Reprinted from *Commentary*, December 1989.
1996a. *Migrations and Cultures*. New York: Basic Books.
Teeple, Gary.
1995. *Globalization and the Decline of Social Reform.* Atlantic Highlands, NJ: Humanities Press.
Thernstrom, Stephen and Abigail.
1997. *America in Black and White*. New York: Simon & Schuster.
Thibodaux, David.
1994. *Beyond Political Correctness.* Lafayette LA: Huntington House Publishers.
Weissberg, Robert.
1998. *Political Tolerance*. Thousand Oaks, CA: Sage.
West, Thomas G.
1997. *Vindicating the Founders: Race, Sex, Class, and Justice in the Origins of America.* Totowa, NJ: Rowman and Littlefield.
Wheeler, Jack.
1998. "The Root of the Problem." *Strategic Investment*, June 17, p. 6.
Whitehead, Barbara.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

1997. *The Divorce Culture.* New York: Knopf.

Wicker, Hans-Rudolph, ed.
1997. *Rethinking Nationalism and Ethnicity.* New York: Berg/New York University Press.

Wrench, John and John Solomos, eds.
1995. *Racism and Migration in Western Europe.* New York: Berg/New York University Press.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Stocks for the Long Run
Jeremy J. Siegel
McGraw Hill, 1998

Jeremy Siegel has written a book that could have a great effect on the reader's wealth while challenging conventional academic views. It is written at the popular level but references the underlying academic articles (i.e. it is footnoted). Siegel is a finance professor at the University of Pennsylvania's Wharton School, so he is well qualified to draw on the academic literature.

The basic message of the book is that stocks have been a wonderful long run investment, and can be expected to continue to be so. The emphasis is on the long run, because there is no doubt that stocks can be exceedingly risky in the short run. As an illustration of stocks' short-run risk, consider October 19, 1987, when the stock market dropped by 22.6% in one day (see Miller 1999 for a review of a book focusing on this episode). Because of the short-run riskiness of stocks, one who is saving for an event in the near future (such as the next vacation), runs a considerable risk of losing money. However, most saving is done not for such short-run purposes but for long-run purposes such as retirement, or to leave money to descendants.

Siegel makes a convincing case that stocks are much better for such long-run purposes than either bonds or money market instruments. Bank deposits usually earn even less than money market instruments, and hence are also dominated by stocks. The textbooks I use in teaching finance present evidence that stocks have, on average, outperformed bonds since 1926. Siegel carries this evidence back to 1802, presenting data on the returns from stocks and bonds from 1802 to 1997. Over this long period stocks have had an average return of 8.4%, composed of price increases averaging 3.0%, and dividends averaging 5.4%. In contrast, long-term US government bonds have averaged 4.7%, and short-term US governments, 4.3%. This superiority of stocks held true for major subdivisions of the period studied also.

Economists talk about the equity risk premium, the differential between stocks and bonds, which is usually interpreted as the reward

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

to bearing the risks of equity. This of course varies tremendously year to year. Siegel plots a thirty-year running average of the equity risk premium. It is striking that it is virtually always well above 0% (the exceptions appear to be around 1841 and 1861, which are well over a century ago). Thus, for someone investing for the long run, it appears stocks virtually always exceed bonds in return.

The riskiness of having stocks underperform bonds turns out to depend very much on the holding period. A fascinating graph (showing data from 1802 to 1997) shows the maximum and minimum real (i.e., inflation adjusted) annualized returns for various holding periods (p. 27). For short holding periods, there is the expected result that one can lose more money on stocks than on either bonds or T-bills, frighteningly more. The worst one-year return on stocks is -30.6% (the best is 66.6%). Incidentally, bonds prove to have appreciable risk over short periods also, with the worse bond performance being –21.9%, and the worst Treasury bill performance –15.6%. The bond and Treasury bill losses occur when high inflation lowers their real purchasing power. Bonds have this risk. In addition, they can experience large losses when interest rates rise unexpectedly, reducing their risk.

That stocks are riskier than bonds, and bonds riskier than treasury bills (and bank deposits and other money market instruments) is standard textbook material. It is usually explained by investors disliking risk and being willing to incur higher risk only if rewarded with greater returns. Thus, investors should be willing to hold stocks only if promised much higher returns than bonds.

However, most investors (especially those with large sums of money) have longer horizons than one year. However, the equity risk premium appears to shrink with holding periods. By five years, there is little difference. The worse stock performance is –11%, and the worst bond performance is a negative 10.1%. For ten year and longer holding periods, bonds actually are riskier. The worst ten years for stocks had a real return of –4.1%, while the worst returns for bonds had a return of –5.1%. At a 20 year horizon, the worst real return on stocks is a positive .1% per year, while the worst bond return is –3.1%. Finally, at 30 years the worst stock real return is plus 2.6%, while the worst return is –2.0%.

The same point is made in a table showing for different holding periods the percentage of the time that stocks outperform bonds. For

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

a one-year holding period, stocks outperform about 60% of the time, while for a thirty-year period they outperform 99.4% of the time. Thus, for long holding periods stocks are actually the lower risk asset.

Why are stocks lower risk? A big reason is inflation. Although stock values are adversely affected by inflation in the short run, in the long run, representing claims to income from real assets such as real estate, their value tends to rise with inflation. More importantly, inflation greatly reduces the returns from bonds and money market instruments. Many investors appear to underestimate the impact inflation can have when compounded over a long period of time (just as they underestimate the power of compound interest). They thus think of fixed monetary return instruments as safer than they really are. Over longer periods of time, in real (inflation-adjusted terms) stocks are safer than bonds.

Siegel also asserts that stocks have a mean reverting return. This means that periods of above normal return are followed by periods of lower than normal return. Stocks prices are visualized as fluctuating around a long-run value. Sometimes they are well above, and sometime below the "normal" values. A short-term investor may be hurt badly if he buys when prices are above their long-run levels and sells when they are below. However, given the strong upward trend in prices (and the steady stream of dividends), one who is unlucky enough to buy when prices are high is eventually bailed out by the long-run upward drift of stock prices. The point is emphasized by pointing to the good returns eventually earned even by those who bought at the 1929 peak.

There is debate among financial economists as to whether the mean reverting model is best, or whether a random walk model is better. Mean reversion implies some degree of predictability of returns, while a pure random walk implies complete unpredictability. If the probability distribution of returns remains constant, one can calculate the holding-period risks for different periods of times. Siegel presents evidence (p. 32) that the long-run risk of stocks falls below the levels calculated from a random walk. This provides evidence for mean reversion.

Standard textbooks include a discussion of the Markowitz theory for calculating optimum portfolios. They typically fail to discuss how the solution varies with the holding period. Siegel provides calculations showing how the percentage of bonds should vary with

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the intended holding period. As textbooks explain, even for minimum risk there will be some of the riskier asset held because of the benefits of diversification. With a one-year holding period, the minimum-risk combination is primarily bonds with only 7% in stocks. However, for a thirty year holding period the stock share for minimum-risk rises to 71.3%. For investors willing to tolerate greater risks, a similar shift to stocks occurs. For those whose risk-tolerance at a one-year holding period is such that a half-bonds, half-stocks mix was appropriate, the optimal mix for a 30-year holding period was 112.9% in stocks (put all money in stocks and then borrow enough to put an additional 12.9% of your wealth in stocks).

Much of the risk in the above portfolio is the risk of inflation's reducing the real purchasing power of the bond component of the portfolio. However, in 1997 the US government introduced bonds that were protected against inflation. These are appropriately treated as the risk-free asset in a standard analysis with the assets being bonds (non-inflation adjusted) and stocks. Then the efficient (in the technical sense) portfolio is long 195% stocks and short 95% bonds.

Having made the point that stocks make an excellent investment for the long run, the middle of the book discusses investment strategies. It is shown that investing in the ten Dow-Jones Average stocks with the highest yield (sometimes called the dogs of the Dow strategy) regularly beats the Dow. From 1928 to 1997, it would have earned 13.21% per year, while buying all of the Dow stocks yielded 11.40%. The success of this strategy is attributed to the Dow being composed of thirty well-established companies that are unlikely to disappear. However, their stocks sometimes go in and out of fashion. When a stock is unfashionable, it finds buyers only at a lower price. This raises its yield. Since such well-established companies usually come back, the strategy of buying the highest-yielding Dow stocks yields higher returns than buying all stocks.

Attention is paid to various other rules for picking stocks. The small stock (low capitalization) effect is discussed, showing that the smallest tenth of stocks on the New York Stock Exchange from 1926 to 1996 had averaged 13.83%, versus 9.84% for the largest firms. This effect is by now well known, being mentioned in most textbooks. However, he also shows that most of this effect occurred in the period from 1975 to 1983, when small stocks averaged 35.3% versus 15.7% for large stocks. Outside of that period, the average returns on

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

large and small stocks were similar. Because there were periods of several years when one or the other size-category pulled ahead, it would increase risk to specialize in one size-category.

One of the potentially more profitable charts in the book (p. 99) tabulates return by both size and book-to-market ratio (July 1963-June 1996). The book value is the firm's book value per share, and the market value is the price. Several earlier studies have shown high book-to-market value stocks have outperformed low book-to-market ones. Siegel shows that for the largest firms (which dominate the averages) this is primarily due to the period 1975-1983. However, as the firms become smaller, the high book-to-market value stocks (value stocks) increasingly out-perform the low-book-market stocks. The latter stocks are typically growth stocks, because investors will usually bid a stock up to a high price (relative to the value of the assets) only if they foresee high growth in earnings. For the smallest quintile in stock size on the New York Stock Exchange, the value stocks averaged a return of 19.51% (for July 1963-June 1996), while the growth stocks averaged only 6.67%. During this period, the 19.51% return on small-value stocks was the highest category, while the lowest return was on the small-growth stocks. Even more strikingly, if 1975-83 were excluded, the small-growth stocks had an average return of only .99%. Avoiding the small-growth stocks could be one of the major lessons of this book, and a very profitable one.

Siegel discusses briefly why the small-growth stocks became overvalued, saying "investors get overexcited about the growth prospects of firms with rapidly rising earnings and bid them up excessively ... while those firms providing solid, although uneven, earnings are neglected." (p. 98).

The writer of this review has provided in several papers (Miller 1977, 1999) an explanation for why small growth stocks have tended to have such low returns. While conventional theory presumes investors have homogeneous beliefs about stocks, and that investors are as willing to take short positions as easily as long positions, observation shows investors do disagree greatly about the potential returns on stocks, and that they seldom take short positions. Standard demand-supply analysis then shows that the prices are higher the greater the divergence of opinion. The price is set not by average opinion, but by the opinion of the most optimistic investors. The greater the investors' divergence of opinion, the greater the gap

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

between average opinion and the opinion of the price-setting investors. The small-growth stocks are likely to be the stocks with the greatest divergence of opinion, since it is very hard to know what the future will bring, especially for companies that basically have just an idea. Over time, the divergence of opinion tends to decline. This decline in the divergence of opinion implies lower prices, all things being equal. This in turn implies much lower returns. Incidentally, the whole process is consistent with investors' estimates being on average unbiased.

As noted above, one of the striking findings of this book is that what finance professors call the size effect (the superior performance of small stocks), is much more striking for "value" stocks than for "growth" stocks. One chapter of interest to older investors (or to those with a knowledge of market history) looks at the "Nifty Fifty" stocks. These premier growth stocks became institutional darlings in the early seventies. They were considered "one decision" stocks that could be bought and never sold. They were bid up to what were later considered ridiculous price-earnings ratios. Their peak was in 1972. Then they collapsed. Bidding them up was considered the height of folly by many later writers. However, Siegel looks at the performance of these stocks into the nineties. He finds that their rate of growth stayed above the Standard & Poor 500 by about three percentage points. This approximately offsets their lower earnings yield. Siegel shows that for the long-term investor who could hold until the present, these were actually reasonable investments, except if bought at the very peak in 1972. Even if bought at the December 1972 market peak, an equally-weighted portfolio (rebalanced monthly) would have yielded 12.7%, only slightly below the 12.9% earned on the S & P 500. The generation of investors that bought these stocks now does not appear to have been so unwise (although they would have had to hold them till the nineties to have done this well).

There are many other chapters that cover such topics as taxes (investing in tax-deferred accounts is wise), global investing (investing some money abroad provides valuable diversification), stocks and the business cycle, the role of world events, etc. Much of the material discussed here will be known to those well-informed about investing, but he does a good job of laying it out in an easy-to-understand form, and fairly often reveals facts that were unknown to the writer of this article, a finance professor.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The chapter on calendar anomalies is particularly interesting. The small-stock effect mentioned above turns out to occur only in January when such stocks have an average 6.2% return (in one month) for 1926-1997, while the S & P 500 has averaged only 1.6%. While the January effect is well, known less well is that value stocks do especially well in January. Much less discussed is the September effect. September is the only month in which the S & P 500 has on average been down (1926-1996). It is also the only month in which a value-weighted (or equal-weighted) world index has been down. International evidence shows that in every country but Austria, January returns have been above-average. Even more amazing, it is claimed that two thirds of the returns outside the US have occurred in the three months of December to February.

Other calendar effects also exist. Examining returns from 1885-1997, Siegel shows that the periods before holidays have been especially profitable. In addition, the week between Christmas and New Year's averages 13 times normal returns. Within each month, the first six calendar days and the last day (and the 30th when not the last) more than equal the entire return for the month. This is probably explained by checks coming around the turn of the month and being invested. What about days of the week? Mondays have been the only day of the week with a negative return.

The book closes with advice to investors. Most long-term holdings should be stocks, not bonds or bank accounts. Although most of the book has dealt with which stocks do best, he points to the difficulty mutual fund managers have had in beating the market, and suggests that individuals picking stocks are unlikely to do better. Thus, index funds or other mutual funds that give a well-diversified portfolio are best. He suggests that for diversification that about a quarter of ones portfolio should be in mid- and small-sized stock funds, and another quarter in international equities. Having earlier discussed the advantages of tax-deferred accounts (such as IRA's, 401(k) plans, or Keogh plans), he suggests maximizing contributions to such plans.

This book should benefit two audiences. The investor may benefit greatly if the evidence of the historical record leads him to focus his long-term (retirement) investments on stocks. The professional economist can expect to learn at least a couple of new facts. A reader who is both (such as the writer of this review) will be doubly blessed.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

References

Miller, Edward M,
1977 Risk, Uncertainty, and Divergence of Opinion. *Journal of Finance*, September, 1151-1168.
Miller, Edward M,
1999 Long Run Underperformance on Initial Public Offerings: An Explanation. University of New Orleans working paper.

Edward M. Miller

Capital Ideas and Market Realities
Bruce J. Jacobs
Blackwell 1999

Capital Ideas and Market Realities deals with modern financial theories, financial engineering, and causes of financial crashes. There is a brief forward by Nobel Prize winner Markowitz. Incidentally, Jacobs, although a holder of a doctorate in finance from the Wharton School of the University of Pennsylvania, is a principal in a successful quantitative portfolio management firm (Jacobs Levy Equity Management) with over $5B under management. He thus can bring both theory and experience to the problem of managing market risk.

Much of the book discusses the major market crashes of recent years, notably the market crash of 1987. The Dow-Jones lost 22.6% of its value on one day, October 19, 1987, the largest percentage decline in history. From its intra-day high on August 25 to the intra-day low on October 20, the market declined by 37%, eliminating over a trillion dollars in investment value. Jacobs makes a convincing case that the severity of the crash can be blamed on an esoteric financial technique called portfolio insurance.

A little financial background here may be useful. An American put option gives the privilege of selling a stock at a fixed price within a fixed period of time. Put options are frequently used to provide insurance against loss for a particular stock. For instance, purchasing a put at $100 means you can always (within the term of the option) sell the stock for $100. Worried about the risk of a stock going down, individual investors sometimes buy put options to assure that they do

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

not lose too much if it declines, while retaining the chance of making a profit if it goes up. Other investors who write (sell) the puts are providing the "insurance" in exchange for the price paid for the put. This is conceptually similar to a standard insurance contract. However, portfolio insurance is a trading strategy for managing risk, not a real insurance contract that transfers risk.

Modern financial theory shows that if stock prices move without gaps, that one can construct the equivalent of a put option by a suitable trading strategy (an appendix explains how this works for the non-specialist, and another appendix discusses option theory). In the eighties such strategies (often called portfolio insurance) were marketed to institutional investors (notably by Leland, O'Brien, Rubenstein Associates). These investors wanted to participate in the rising equity market, but were worried about the losses they could encounter in a market decline, what such loses would do to their clients and to their relationships with their clients. While the earlier plans provided for trading stocks, most of the later plans provided the desired exposure to stocks by trading index futures.

Part of the book deals with the case against portfolio insurance, and why it is likely to be an unwise strategy for institutional investors. The theory behind portfolio insurance requires that price changes be smooth, but in practice gaps occur. Obviously, if the option replication strategy depends on sales at a particular price, and the market drops suddenly to below that price, a key assumption behind the strategy is not met. Portfolio insurance strategies are designed to limit losses over a specified period, often one year. This is inconsistent with optimal (rational) behavior for investors whose planning period is much longer than a year (such as the pension funds and endowments insurance was sold to). The arguments against portfolio insurance are powerful enough that one wonders why managers of at least 68 billion dollars in assets (total of list on p. 140) bought into such a strategy. The answer probably relates more to good salesmanship by the vendors of such schemes and to the desire of managers to be protected against loss of their jobs in the next market decline than to rational managers making decisions in their clients' interest. However, portfolio insurance and related strategies have what economists call externalities. They increase the risk of market crashes, and increase the number of Americans who suffer large market losses. By increasing market risk they discourage

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

investment in both financial and real assets.

Jacobs makes a strong case that portfolio insurance explains why the 1987 crash was as severe as it was. Portfolio insurance is a trend-following trading system. As markets go down, the formulas call for selling stocks or futures (insurers sell about 2% of their portfolio in response to a 1% market decline). This selling puts downward pressure on stock prices, causing the insurance formula to call for more selling. The result is a cascade of self-reinforcing selling, which produced the incredible 1987 one-day decline of 22.6%.

Admittedly, most of the portfolio insurance selling was of stock index futures, not of stocks. However, index arbitragers sell stocks and buy futures whenever a profitable opportunity exists. Thus, sales of futures by portfolio insurers should have led to sales of stocks by arbitragers, and normally would have. However, in the confused conditions of the crash, the normally tight link between the futures and stock markets was broken, and futures were forced down to an abnormal discount (see diagrams on p. 155). Apparently arbitragers, uncertain of prices, and with limited capital, traded less than would have been required to keep futures at stock market equivalent levels. Many portfolio insurers, seeing that selling futures would be uneconomical, sold many fewer futures than their computer programs called for. However, the portfolio insurers' formulas called for such heavy selling after declines that even the part of the required selling that was actually done was a major cause of the severity of the crash.

Because portfolio insurance is a formula-trading system that involves selling when the market goes down (irrespective of any information as to whether the market will rise soon again), it is inherently destabilizing, and contributes to the risk of future crashes.

While the inability of portfolio insurers to make all of the sales their formulas call for moderates the immediate destabilizing effect of the strategies, it also constitutes one of the weak points of the strategy. If the sales were made at the depressed prices for the future, the losses would have been even greater than intended. To the extent the sales were not made, the insurance proved ineffectual. Thus, when put to the test, portfolio insurance proved not to provide the promised protection.

Not surprisingly, after the 1987 crash many institutions discontinued their portfolio insurance programs (see their Figure 13.4). However, Jacobs argues that trend-following trading systems

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

continue to exist; and in discussing other, more recent crashes (1989, 1991, and 1997), he argues that they played a contributory role. The most fascinating account concerns the recent (1998) collapse of the hedge fund Long Term Capital. Once again there was the illusion that with the aid of modern financial theory, and its quantitative practitioners, risk could be avoided. This firm was able to borrow massive amounts, and then to use derivatives to add further to its leverage. When its strategies failed to work, its efforts to unwind the positions played a major role in producing a market decline. Part of the decline was because investors were not certain whether it would be compelled to liquidate its positions in a hurry. Finally, the Federal Reserve organized a bailout in which 90% of the equity was purchased by major financial institutions, thus reducing the risk of a forced liquidation.

Jacobs argues that while there is much less portfolio insurance now than there once was, similar dynamic hedging strategies are still being employed, and have a potential to contribute to future market meltdowns. Institutions still want downside protection. With the weaknesses in portfolio insurance having been shown, institutions are now frequently purchasing over-the-counter puts written by brokerage firms and other financial institutions. These firms often lack the capital to cover the losses that would be incurred in a major market decline. There appears a shortage of individuals and firms willing to take an offsetting position to the institutions (i.e., to write puts). Thus, the brokerage firms must hedge many of these puts through one of several dynamic trading strategies. Such a firm can be in a hedged position if it offsets the losses it would incur in a market decline by selling stocks short (in a decline the shorts would make money, offsetting the losses), or by selling futures, or by engaging in more elaborate hedging operations.

However, the size of the short position required to hedge a put increases as the market goes down. Thus, such hedging calls for selling into a market decline. Jacobs, noting the vast quantity of over-the-counter puts written, argues that a decline can feed on itself with the firms that wrote the puts being forced to sell more and more as the market declines, forcing the market steadily lower. There is no way for other market participants to know which selling is a purely mechanical response to the market decline, and which reflects information about bad news yet to come. As a result, other

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

participants become unwilling to take the opposite side of the trades required by the sell orders, and the decline accelerates. The result is potential for a scenario similar to that of 1987, except that the selling is not coming from portfolio insurers, but from firms that have written puts.

This is the truly worrisome message of the book.

Edward M. Miller

Luxury and Status: Why Money Fails to Satisfy in an Era of Excess
Robert H. Frank
The Free Press, 1999

Robert H. Frank's book is dedicated to showing that excessive real resources are devoted to conspicuous consumption when other uses for these resources would be better for society. Of course, many others have said this. However, Professor Frank does a better job of explaining why this is so, and discussing the resulting policy implications. The basic reason is that human wants are interdependent. What one has affects what another wants.

Frank is one of the few economists seen at evolutionary psychology meetings. Given this, it is a little surprising that his lucid explanations don't include a better explanation of why human wants are so interdependent. Evolutionary psychology is built on the idea that the genes that increase in frequency are those that contribute to the individual's leaving the most descendants, not necessarily those that contribute most to human happiness.

One of the necessities for leaving lots of descendants is survival. As part of this, humans desire food and shelter. Medical care and medicine also contribute to survival. Many human wants can be explained in terms of such simple needs. Traditional economics, where the individual is taken as having a set of wants that are fundamentally independent of the wants of others, deals adequately with these material needs. People can be visualized as trading off the desire for meat versus the desire for vegetables. The gain in one

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

person's happiness (economists use the term utility) from sating his hunger, or from warming his body in winter, or from eliminating the pain of a disease does not have much effect on others' happiness.

At one time, most economic activity, at least among the working classes and peasants, was directed toward meeting such material needs. It was in such conditions that Adam Smith's book *The Wealth of Nations* was written. Even today, economics textbooks implicitly have such needs in mind.

However, today in the industrial world most people have their material needs for food, shelter, and medical care met. Instead, our efforts are devoted to seeking status, and conspicuous consumption. Today, most consumption is not to meet material needs, but to impress others.

Frank frequently uses a large house or a fancy automobile as examples of conspicuous consumption. While such consumption raises the status of those that have the items, it also lowers that of those that do not have them, leaving little net benefit. He argues convincingly that if we all bought less expensive versions of such items we would derive equal satisfaction, while additional income would be freed up for other purposes, some of which would actually increase our happiness without lowering that of others.

Frank provides empirical evidence for the folk wisdom that material goods do not bring happiness. Surveys of happiness and satisfaction with life conducted at regular intervals show that happiness has not increased even over time-frames where the level of material consumption has greatly increased.

In spite of his evolutionary psychology background, Frank does not go deeply into why we derive pleasure from conspicuous consumption. The evolutionary psychology literature provides the explanation (for a recent exposition see Low 2000). The reason is that humans compete for mates, and especially, men compete for women. Over the thousands of years of human evolution, women who selected high-status males for mates enjoyed more protection and resources for themselves and their children. This permitted them to leave more grandchildren, and this caused the genes for such behavior to spread. By now humans have a built-in tendency to seek status and to seek to impress other humans. Because our mating success over the years has depended on our status, we are status-seekers. Much of our desire for conspicuous consumption evolved because signaling our

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

resources increased our reproductive success.

One of Frank's complaints is that the human desire for conspicuous consumption leads to too little saving. This doesn't follow logically from a desire for conspicuous consumption. Since conspicuous consumption in the future will also be sought, saving for future consumption is encouraged, just as current consumption is.

However, the evolutionary reasons that lead to a desire for conspicuous consumption also may make current consumption preferred. Humans are a pair-bonding species that usually marries young, and often stays married for life. Reproductive success has often depended on the quality and number (for males) of mates they could acquire. Mate acquisition occurs young, and those who impress future mates at a young age normally would have left more descendants than those who retained the resources for future use. A more comfortable (or longer) life after children have been raised does little to increase reproductive success, and impedes success if it reduces the resources available for mate acquisition. Admittedly, parents can use resources to assist children or grandchildren. However, because on-average children have only one-half of the genes of a parent, and grandchildren only a quarter, a given amount of resources has more value if devoted to the parent's survival and mate acquisition early in life than if passed on to children or grandchildren.

Thus, although Frank is correct (he provides calculations) that if the typical family would only reduce their consumption for a few years, they could consume more for the rest of their lives, his belief that the problem is the desire for conspicuous consumption remains unproved. The reluctance to save is adequately explained by humans preferring current consumption to future consumption. As noted, there are good evolutionary reasons why humans have evolved to have such preferences.

Frank clearly believes that higher savings and the resulting higher rate of economic growth are good things. He also recognizes the standard argument for letting people decide on their savings rates, and hence on how rapidly their consumption will grow over time. He suggests that growth has external benefits similar to that of defense (p. 247). However, he fails to recognize that because growth contributes to defense, and a strong economy deters other nations from waging war, there is a defense externality (see Miller 1976).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

There are several problems with the book. His basic policy proposal is a progressive consumption tax. In practice this would be achieved by modifying existing income taxes to allow unlimited deductions for savings. The unsaved part of income represents consumption.

Interestingly, he leaves out the major theoretical reason for thinking the replacement of an income tax by a consumption tax would increase savings. That is, that the income tax greatly lowers the return to saving since the interest and dividends are taxed, and the compounding is taxed. With a 40% income tax, sacrificing a dollar's worth of consumption lowers the rate of return on investment by 40%, say from 10% to 6%. Compounded over many years, the gain from saving and investing are greater in a world where consumption is taxed, than where income is taxed.

Alas, for a book that argues for a change in the tax system there is very little discussion of the problems of implementation and of transition. In theory, repaying debt and saving are the same, and borrowing is negative saving. Thus, if one exempted saved funds from the new tax, one would also include borrowings. Normally, people save during their working years and then dis-save during retirement. Under the current system they are taxed heavily during their working years, and are taxed relatively little during retirement when their income is much less. Under a consumption tax, the retired would pay heavier taxes and those saving for retirement less. However, during the transition there would be a generation who had been taxed while saving for retirement, and are again taxed heavily during retirement. This would be inequitable. However, this rather obvious problem is not mentioned in the book. Likewise, an obvious problem would be the person who saved heavily, and then went abroad to spend his money and avoided being taxed on this consumption. Solutions are possible, but one would like to have seen at least a mention that there are such problems.

He argues that a consumption tax would favorably affect career choice (p. 236). An earlier book of his dealt with the "winner take all" economy. He argues that in many parts of the economy there are very high returns from being first, such as in athletics, music recordings, law, mergers and takeover investment banking, etc. Because the rewards in these fields are so large, the brightest and best often enter these occupations. Like many social observers, he

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

believes that social welfare would be increased if more went into teaching, engineering, and the civil service. He mentions a study that argues that the US growth rate would be increased by half a percent by a doubling of enrollments in engineering, while doubling enrollments in law would actually reduce it by one half of one percentage point. His argument is that if taxation took more of the returns from the winner-take-all occupations, people would be more likely to select more socially useful occupations. The chief problem with this argument is that if people derive great pleasure from being first in consumption, a consumption tax that causes everyone to consume less will still leave some consumers as clearly being first. People will continue to compete to enter the occupations that pay enough to permit them to engage in conspicuous consumption.

Shortly afterwards he argues that the problem of occupational choice is similar to gold prospecting. Without providing a citation or a strong argument, he claims that additional prospectors contribute very little to the total amount of gold found, although they may contribute to the gold being found earlier. He never spells out the model, but this outcome is unlikely if prospectors stake out a parcel of land and intensely search it. They will stop searching when they have explored that land. The outcome he describes is possible if there is no ownership of claims and prospectors just randomly search the same lands without marking which land they have searched. If there are enough prospectors to search the whole gold region, there can be wasteful duplication. If it is the latter model he has in mind, he should have said so. He uses acquisition and merger lawyers as an example where there is a limit to the total fees to be earned and argues that too many of America's brightest are competing for these positions.

If it is true that material objects are the major signs of status, it is true that people will seek out the higher-paid occupations. However, there are other things that bring status. Academics seek a long publication list and fame from their discoveries. Many seek a reputation for good works. One set of policies Frank does not discuss would try to raise the prestige of these other activities.

Britain is very fortunate in that much prestige comes from being knighted. Those who have been knighted are called Sir, and are treated with high respect by others. Frequently the activities that lead to knighthood are socially useful, probably more useful than the usual

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

accumulation of material goods. The US and other countries might benefit from having similar, well-recognized honors.

Frank praises time spent at home with family and friends. He contrasts paid work with the delights of socializing with friends and family and spending time on ones hobbies. However, much time spent on hobbies and activities outside of work is really devoted to seeking status. An example is building up impressive collections containing rare objects other collections lack. Much time is devoted to winning competitions of various types. If we had more free time, we would probably devote more time to such activities. However, it is not clear we would be much happier.

In a book devoted to showing how wasteful and non-satisfying our efforts to accumulate luxury goods are, one might have thought that Frank would come out in favor of taxes on status goods. Having given the standard economist's argument for taxing activities that produce pollution (an adverse effect that is not reflected in market prices), Frank could be expected to propose taxes on forms of consumption that make others feel less good. But he does not.

The author of this review has written a paper proposing the taxation of status goods (Miller 1975). Status goods are those that serve to establish status and derive much of their value from the ability to impress others with their cost. A classic example would be a piece of diamond jewelry, much of whose purpose is to impress others. If diamonds were to be twice as expensive, a somewhat smaller jewel would probably serve the purpose just as well. Suppose there was a heavy tax on diamonds. Diamonds would be more expensive, but the owners of a diamond of a particular price would probably derive about as much utility (happiness) as before. Yet the government would have additional revenue that could be used for many desirable purposes. Similar arguments apply to other status goods such as large houses and high-performance automobiles.

Why does Frank reject this argument? He points to the problems in designing and administering such taxes. Since the manufacturers and consumers of goods classified as luxury goods will be hurt by such taxes, they will expend much effort and money in lobbying against them (economists sometimes call this rent-seeking). Frank points out the same good may be wanted sometimes for status reasons and sometimes because of the pleasure it brings the owner in some other way. His example is that one person may like a high-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

performance car because of the pleasure of driving it, while for another the chief utility is in impressing others. A tax aimed at the first individual will also penalize the latter one.

There is also a risk that resources will be wasted in evading status taxes. Suppose a low-priced car is regarded as a necessity (at least in America) and a heavy tax is placed on the price above a certain amount. Cars will be sold that fall under the cut-off price, but which can easily be upgraded (e.g., the basic car is without fancy electronics or air-conditioning, but the purchaser then has these installed).

These problems definitely exist, but it still seems clear that some items of expenditure are for the relief of pain (most medical care) or discomfort, and others much more for status. Major social gains might be derived by a system of selective taxation of status goods.

Another possibility is to try to increase the prestige society gives to accumulating wealth. Keynes pointed out that society seems to have an implicit agreement with entrepreneurs. They would be allowed to accumulate vast fortunes with the understanding they would consume only a little of the income from these fortunes, investing the rest. Such reinvestment contributes to economic growth and serves to raise the incomes of the laboring classes, since they have more capital to work with.

However, there is social pressure not to boast of how much you have (to do so would be gauche) and much wealth is held as stocks and bonds where it lacks the visibility of a family business. Thus, people resort to conspicuous consumption as a way of obtaining status (and indirectly mates). If people are able to obtain status without conspicuous consumption, they may do less such consuming, freeing up resources for satisfying other human wants and needs.

Overall, Frank has done a good job in documenting that human wants are interdependent, and that economic theory and policy that treats individuals as being isolated from each other is over-simplified. However, he does a poorer job of making a strong case for what he believes to be the policy implications of these interdependencies.

References

Low, Bobbi
2000 Why Sex Matters. Princeton, Princeton University Press.
Miller, Edward M
1975 "Status Goods and Luxury Taxes." *American Journal of*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Economics and Sociology, April, 141-154.
Miller, Edward M
1976 "The Defense Externality." *American Journal of Economics and Sociology*, October, 271-274.

Edward M. Miller

The American Dream: Can It Survive the 21st Century?
Joseph L. Daleiden
Prometheus Books, 1999,
Amherst, New York 738 pages, Hardcover

Can "The American Dream" survive the 21st Century? Based upon the author's findings, the answer is "no". And if the U.S. government continues current policies, which are economically myopic, socially dysfunctional, and politically centrifugal, not only "The American Dream" but America, itself, will not survive. These destructive policies, as the author explains, are the result of successful lobbying by two "powers" that emerged in the 1950s and 1960s. They are: (a) special interest groups advancing agendas based on race, ethnicity, religion, language, culture, age, sex, sexual orientation, handicap status, and academic and business "needs", and (b) the ideological fixations of liberals and conservatives.

These "powers" were able to exert such influence because "The American Dream" lost its original meaning. The dream expressed by Thomas Jefferson in the American Declaration of Independence to "establish a nation on the principle that all men had the 'right to Life, Liberty, and the Pursuit of Happiness' " has been replaced over the years by a multitude of different, at times, conflicting definitions. If "The American Dream" can denote everything, it means nothing. Absent a common bond, the unraveling of society is all but inevitable. This slow unraveling became a rapid deconstruction after radicals from the 1960s assumed leadership roles in the academic, economic, and political fields. Since then, "The American Dream" has been redefined to mean the superiority of the individual over society, of rights over responsibilities, of materialism over morality, of consumption over savings, and of the present over the future.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Can this self-destruction be reversed? The author – who has worked as a statistician, demographer, business economist, urban policy analyst, and strategic planner in the public and private sectors – argues it can be provided the public recognizes the solution is complex, multifaceted, and requires immediate implementation. To highlight this importance, Chapter One is entitled "Two Scenarios for the Year 2050". Here, depending on whether or not the necessary reforms have been instituted, two radically different Americas are presented in the State of the Union address given in 2050 by the President of the United States to Congress. Without necessary reforms, the United States has politically disintegrated, like the old Soviet Union, with seven Southwestern States seceding and forming an independent "Hispanic" country. The rump United States has declined to the level of a Third World country due to overpopulation already at 500 million and projected to reach a billion in fifty years – and its corollaries: environmental destruction and rampant crime. The second scenario, after the necessary reforms have been adopted, depicts a United States that has remained united politically and culturally, is economically and academically sound, and is enjoying an improved standard of living that is, most importantly, sustainable into the future.

In the next twelve chapters, the author examines the serious problems confronting the United States – population growth, immigration, environment, deficit, trade, poverty, welfare, education, crime, health care, and taxation. Various solutions are presented balancing those advanced by liberals with those proposed by conservatives. After offering a critique on their respective strengths and weaknesses, the author submits his own recommendations.

The author advocates, first and foremost, a liberation from the mental straitjacket of the political ideologies of liberalism and conservatism as they currently exist. As a matter of faith, liberals believe in egalitarianism and conservatives in meritocracy. To prove the truth of their respective "faiths", the former seek bigger government and more regulations, while the latter seek less government and fewer regulations. Commitment to these secular "faiths" insures that specific government programs are continued even when empirical evidence shows they do not work.

Therefore, the author calls for solutions based on pragmatism. This pragmatism would promote what he calls "the three harmonies"

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

and a modified theory of Rawlsian justice.

The three conditions are:

1. Individuals must, to some extent, have the opportunity to fulfill their basic biological needs to be in harmony with their genetic nature.
2. Fulfillment of the needs of individuals must be reconciled to the needs of others, i.e., to a reasonable extent, individual needs must be brought into harmony with societal needs.
3. The aggregate needs of society must be fulfilled in a manner that is in harmony with the environment, i.e., aggregate consumption cannot exceed the carrying capacity of the environment."

These are complemented by a modified theory of Rawlsian justice that reads: "All social primary goods (liberty and opportunity, income and wealth, and the basis of self-respect) are to be distributed equally unless an unequal distribution of any or all these goods is to the greater (relative) advantage to the least favored."

One of the first important points raised by the author is how the metamorphosis of "The American Dream" into the pursuit of materialism has not, contrary to advertisers' assertions, produced happiness. "A 1995 study showed that most Americans felt poorer than they did thirty years before when real incomes were almost 30 percent lower than the 1995 levels."

Next he addresses the Gross Domestic Product or GDP. While the rising GDP of the United States is frequently cited by the government, economists, and the media as proof of the country's economic well being, the author points out that since the GDP is an average it presents a false image of prosperity.

The author presents data the GDP ignores. For example, from 1966 to 1970, the lowest quintile of American families saw their income increase by 22 percent. However, from 1980 to 1997, that income dropped by one percent. Meanwhile, the top quintile saw their income grow 29 percent from 1966 to 1979 and a further 34 percent from 1979 to 1997. It appears "99 percent of all the economic gain between 1979 and 1994 went to the upper 5 percent of income earners."

In 1980, CEOs made 42 times what factory workers received. By 1994, CEOs made 53 times the average factory worker's pay, and among the largest U.S. companies it was 225 times greater.

This occurred while the hourly earnings adjusted for inflation, which

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

had risen 50 percent from 1950 to 1970, from $5.34 an hour to $8.03, dropped by six percent, to $7.54, from 1970 to 1997.

At the same time, weekly earning, which had increased 48 percent from 1950 to 1970, dropped 21 percent by 1997 to 1973 levels.

During the 1950s and 1960s, family income grew on average by 3 to 4 percent. After 1973, it grew by less than 1 percent.

Real per capita disposable income adjusted for inflation actually rose 59 percent from 1950 to 1970 and 62 percent from 1970 to 1997. This was due in large part to more hours worked and the necessity of having a two-income family.

The result has been a growing gap not only between rich and poor, but between the rich and the middle class as well. The emotional impact of such growing economic inequalities are reflected in the Louis Harris poll used to calculate an Alienation Index. This index jumped from 29 in 1969 to 65 in 1993.

Alienation based on the perception among the middle class – the corner stone of a stable and prosperous democratic society – that their economic position is deteriorating, and among native-born poor, especially poor blacks, that they are economically worse off today than they were years ago are recipes for potential political instability.

The author explains how the economic, social, and political problems confronting the United States are the result of overpopulation. And this overpopulation is driven by Third World immigration. The combined number of legal and illegal aliens entering the United States annually is now approximately 1.5 million – the highest level in the history of the United States.

Immigrants and their descendants accounted for two-thirds of the U.S. population growth during the 1990s. They are projected to be responsible for virtually all of the population growth in the United States hereafter. The Census Bureau now projects that the U.S. population will increase from 269 million to 400 million by 2050. However, Census Bureau projections are notorious for underestimating U.S. population growth. If immigration, legal and illegal, is higher than anticipated the U.S. population could reach 500 million by 2050. And by 2080, it could exceed 800 million.

What are some of the consequence of such population growth?

Currently, "one percent increase in the immigrant composition of an occupation reduces wages at least 0.7 percent".

By 2050, U.S. arable land will be reduced by nearly 40 percent from 470 million acres to 290 million acres due to population generated development. The United States, historically a food exporter, will become

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

a net food importer. The standard of living will fall towards Third World status.

There are more immediate problems. By admitting Third World immigrants, the US government is importing poverty, illiteracy, infectious diseases, and crime.

Third World immigration is also responsible for higher unemployment among blacks, lower wages for the poor, and increased costs for welfare, SSI, and public education, and increased environmental degradation.

Below are a few examples cited by the author of how Third World Immigration adversely impacts employment, social services, and crime:

- Immigration cost U.S. workers $133 billion a year due to depressed wages.
- From 1974 to 1996, the minimum wage dropped 34 percent in constant dollars.
- More than 2 million U.S. workers were displaced in 1992 alone.
- Third World immigrants are beneficiaries of affirmative action programs originally meant for black Americans allowing Third World immigrant-owned businesses to discriminate against blacks with impunity.
- Net cost of immigration to U.S. taxpayers since 1970 reached $65 billion annually by 1996 and is projected to jump to $866 billion for the period 1997 to 2006.
- Immigrants are a net cost to Social Security of about $1,000 per person annually.
- Immigrants who arrived before 1988 were 56 percent more likely than native born Americans to be living in poverty and 25 percent more likely to receive public aid and have an average per capita income from public assistance of 14 percent more than native born.
    - In 1995, the General Accounting Office, GAO, reported immigrants are now twice as likely to receive public assistance as the general population.
- By 1990, the cost of bilingual education was $7.5 billion – one thousand times the original 1968 estimate.
- Incarceration rate of illegal aliens is three times the U.S. average.
- In 1994, 25 percent of inmates in federal prisons were aliens.
- Since 1980, there has been a 600 percent increase in alien inmates.
- In Los Angles, alone, there are an estimated 600 ethnic gangs with over 100,000 members.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

In the last chapter, "Putting It All Together", the author lists specific proposals to save "The American Dream". The reader may find many of his recommendations to be controversial, but all need to be given a fair hearing. Since America's problems are interconnect, the author warns that partial measures, or "compromises" in the vocabulary of politicians, will not be successful, and will only result in the proverbial rearranging of the deck chairs on the Titanic.

Joseph E. Fallon

Crimes and Mercies

James Bacque

Little, Brown and Company (Canada) Limited, 1997

"At least 9.3 million Germans died needlessly soon after [World War II], the great majority because of the conditions imposed by the four major victors," according to historian James Bacque in a sequel to his earlier book *Other Losses*. The figure may go as high as 13.7 million.

Does anyone care? The myths that survive in Western public opinion and within the prevailing intellectual culture seem impenetrable. Bacque's is the latest of several learned books, including those by Alfred-Maurice de Zayas and Victor Gollancz, that have appeared in recent decades about the atrocities committed against German civilians and prisoners of war in 1945 and for five years thereafter. A reason for yet another book is that Bacque has had the benefit, as those who preceded him have not, of the KGB archives in Moscow. The opening of the Soviet archives has been a source of illimitable information for those seeking to understand the twentieth century. Another reason, of course, is that the world has largely ignored the earlier books. Serious scholars will need to repeat again and again the many facts that are required to give perspective and balance to the understanding of history. Otherwise, myth and prejudiced selectivity will remain as the permanent historiography of our age.

The title *Crimes and Mercies* reflects Bacque's desire to remind us that, along with the atrocities, some wonderfully humane things were

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

done (hence, the "mercies"). There was potential famine in many parts of the world at the end of the war, precipitating a concerted effort especially by the United States, Canada, Australia and Argentina. It is an amazing figure, but former U.S. president Herbert Hoover, who spent much of his adult life in food relief, estimated that as many as 800 million lives were saved.

The post-war atrocities committed against the Germans took a grisly toll on three categories of people: the residents of occupied Germany, of whom 5.7 million are said to have died; the 15 million who were expelled from eastern lands and forced west toward what later became West Germany, of whom anywhere from 2.1 to 6.0 million died (it was Konrad Adenauer who put the figure at 6 million); and the prisoners of war, of whom from 1.5 to 2.0 million died.

The residents of occupied Germany. For a considerable period after the end of the war in May 1945, the German people were subjected to starvation conditions despite an abundance of available food. Germans speak of 1947 as the *Hungerjahr*. Red Cross food trains were sent back to Switzerland; all foreign governments were denied permission to send food; fertilizer production was sharply reduced; such food as there was was even confiscated, especially in the French zone; and the fishing fleet was kept in port. In 1945, Mennonites were forbidden to send food to their co-religionists in Germany. The taking of eastern Prussia to make it a part of Poland deprived Germany of 25 percent of its arable land. "What finally assured the prolonged starvation of Germans was the enforced reduction of industry," Bacque says. The Morgenthau Plan to reduce Germany to an industrial wasteland was said to have been cancelled, but it wasn't. "By autumn 1945, industrial production was deliberately reduced to around 25-30 percent of pre-war levels," even though the war itself, with all its bombing, had hardly affected German industry, which at the end of the war still had 80-85 percent of its plant intact. The dismantlement of German industry was still continuing, indeed rising, in 1949, which saw the removal of all or part of 268 factories. In January 1947 the allotted daily ration per person in the French zone was 450 calories, whereas health experts say that from 2 to 3 thousand calories are needed for good health. Influential American senators such as Taft, LaFollette and Wherry protested "the deliberate and wholesale mass starvation" in the American, British

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

and French zones of occupation. Wherry told the Senate that "the truth is that there are thousands upon thousands of tons of military rations in our surplus stock piles that have been spoiling right in the midst of starving populations."

The starvation is confirmed by the experience of Arthur Jacobs, the 12-year-old American boy who, born to German parents, was deported to Germany from the United States at the end of the war, transported in mid-winter in an unheated box car for four days, held in a prison at Hohenasperg (where he turned thirteen), and then forced to grub for food, along with the rest of the German population, to survive. He later returned to the United States and became a career officer in the United States Air Force. Readers of the *Journal* will recall the review of his book *The Prison Called Hohenasperg* in the Fall 1999 issue.

The starvation wasn't all. At Yalta, for example, it had been agreed that Stalin could take "reparations in kind." It is estimated that he transported 874,000 German civilians to the Soviet Union for slave labor, of whom 45 percent perished.

The 5 million expelled from the east. The creation of the Slavic states out of the break-up of the Austrian-Hungarian Empire at the end of World War I had created a diaspora of some five million Germans who then lived outside Austria. In late 1944 and early 1945 as the Red Army swept into eastern Europe, large numbers of these Germans (and others from the eastern regions of Germany) fled west in a desperate effort to escape the multiple rape, killing, even crucifixion, or seizure for slave labor that awaited them. The slaughter at Nemmersdorf and many other towns deserves to be as infamous as the Soviet execution of the Polish officer corps at Katyn. It was a period known as "the time of the women," since the refugees consisted almost entirely of women and children.

Atrocities against these refugees were committed not just by the Red Army but by Czechs, Jews, Tito's partisans, and others. The refugee columns were strafed, ships loaded with thousands of refugees (such as the freighter *Goya*, with 6 to 7 thousand refugees aboard) torpedoed and sunk. Perhaps the greatest mass atrocity was committed by the combined U.S. and British air forces when they fire-bombed Dresden, a city with no military significance, in mid-February 1945. The city was filled with perhaps as many as 600,000 refugees. The bombing was done by 1,400 British planes, followed by

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

450 American bombers. The International Committee of the Red Cross estimated 275,000 dead; other estimates run from a low of 40,000 to a high of 400,000. This mass killing of refugees was an extension of the wartime policy of "area bombing" to kill German civilians, particularly in the working-class neighborhoods around industrial areas. It is estimated that 600,000 German civilians were killed by this bombing during the war.

The flight westward as the war reached its final stages was followed during the post-war period by the expulsion of German civilians from East Prussia, Pomerania, East Brandenburg, Silesia, Bohemia, Moravia, Slovenia, Croatia, Serbia and Transylvania that began in March 1945 and continued into 1949. These were Germans whose ancestors had lived in those areas for as long as 700 years. Even though the Potsdam Agreement had specified that the removal was to be "humane and orderly," the brutality was often extreme. Many of the deportees were placed in camps to await expulsion, and were met with sadism and slow starvation. De Zayas reports that "tens of thousands of German civilians perished in Polish internment camps while awaiting 'transfer' to Germany." According to de Zayas in *The German Expellees*, Tito's camps in Yugoslavia "were consciously and officially recognized as extermination centers."

The German prisoners of war. Bacque says the Western democracies "maintained camps where about one million German prisoners of war died of starvation, exposure or disease." The United States Army maintained prisoner-of-war camps in France in 1945 and later in Germany, and placed the prisoners on greatly reduced rations. "Martin Brech, retired professor of philosophy at Mercy College in New York, who was a guard at Andernach in 1945, has said," according to Bacque, "that he was told by an officer that 'it is our policy that these men not be fed.'" "Brech saw bodies go out of the camp 'by the truckload." More than half a million died in the American camps during 1945-6, a fact that was kept secret for 40 years.

This is a history that is to be taken seriously. It is written by capable scholars and published by reputable publishers such as Little, Brown, Charles Scribner's Sons and St. Martin's Press. The events recounted here are no more than a sample of the chilling details. It must be the task of academic historians not to leave such events as the province of a few authors "crying in the wilderness." People of

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

goodwill everywhere, now and in the future, as well as the victims, deserve the fullest explication of what happened and why.

It wouldn't be surprising if some people will justify such mass killing on the ground that "the Germans supported Hitler, caused the war, and committed countless atrocities of their own; there is justice, then, in their suffering, even immensely." The trouble with such a justification is that it overlooks three things: First, that even (or most especially) Nazism was itself a movement rooted profoundly in anger and desire for retribution, based on events of a still earlier period. If atrocities can be justified if they are for retribution, this will justify virtually all atrocities, if one looks back into the historical antecedents. Virtually none arise out of a vacuum. Second, the West has been deeply hypocritical about who precisely has been evil, and why. There is no comparable sensibility toward Stalin (who deliberately starved ten million to death in 1932-3, just to mention one of his horrors), Mao (an estimated 30 million in the Great Leap Forward alone), and Pol Pot. Even this list is far too restricted, since mass murder has occurred in many times and places, not just in remote history but in our own day. What, then, makes German women and children more or less deserving of slaughter than others? Third, it is a peculiar sense of justice that will justify the mass killing of women and children, even if one were to accept the premise of "collective German war guilt."

Bacque, de Zayas, Gollancz, Theodore Schieder for recounting the treatment of the Germans; Nikolai Tolstoy, Julius Epstein, and Nicholas Bethell for telling about the forcible deportation of Russians, and even of Cossacks and non-Soviet Russian emigres, into Stalin's eager but unwelcoming hands at the end of World War II; and Robert Conquest for writing about Stalin's deportation of whole nationalities – all are scholars of courage and great perseverance who deserve to be heard by the "mainstream." What is at stake is our understanding of the twentieth century not in terms of fantasy but of fact.

Dwight D. Murphey

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Family, Kin and City State in Ancient Greece and Rome

N. D. Fustel de Coulanges
abridged and edited by
J. W. Jamieson

CONTENTS

A Religion of Heredity and the Family

The Importance of the Lineage

The Sacred Hearth Fire

Marriage and the Family

Kinship and Property

Moral Law

Gens, Phratry, Tribe and Nation-State

The Domestic Religion as the Moral Foundation of the Ancient City-State

The Decline of the City-State

ISBN 1-878465-15-5 Paperback, 156 pages
$20.00 + $2.50 postage

SCOTT-TOWNSEND PUBLISHERS
P.O. BOX 34070, WASHINGTON DC 20005

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Philosophy of Nationalism

Professor Charles C. Josey

"Nationalism" is perceived as a controversial ideology in contemporary political science. But although it has retreated in the West, it remains a strong force in post-Soviet eastern Europe, and is still paramount in Japan, China, India and most parts of Asia, Africa and Latin America. This work, published under the title of *The Philosophy of Nationalism* provides a valuable insight into what consitutes a nation and how nations may survive.

CONTENTS

Moral Values and the Sacred
The problem of 'multiple allegiances' – should dedication to family, state and nation ethically take second place to the world community? And will it likely do so on an international basis?

The Problems Before Us
Idealism opposes the use of power by those who take a liberal attitude to the interests of foreign peoples and nations, but do nationalists see the goal of world equality in the same light?

Internationalism and the Maximum Good
Internationalism as an ideal, but how to contend with other peoples who do not share this ideal? Nationalism and class warfare.

Internationalism and Our Good
But Internationalism can also be a cloak for commercialism, as well as for transfers of capital from the haves to the have-nots.

The Appeal of Democracy
The sacred nature of democracy – What makes societies democratic?

The Choice Before Us
How to aid others without endangering our own values.

ISBN 0-941694-16-X – Hardback – Price $25.00
VISA AND MASTERCARD ACCEPTED
Scott-Townsend Publishers
P.O. Box 34070, N.W., Washington, D.C. 20043
Tel (202) 371-2700 Fax (202) 371-1523

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Man
Between Past and Future

BRUNETTO CHIARELLI

University of Florence, Italy

CONTENTS

PRIMATE EVOLUTION AND PALEONTOLOGICAL EVIDENCE CONCERNING THE DISPERSAL OF HOMINOIDS

THE FIVE ECOGEOGRAPHIC SUBSPECIES AND THEIR POPULATIONS

CLIMATE, NUTRITION, IMMUNOLOGICAL RESPONSES, FOOD HABITS AND INTELLIGENCE

THE CURRENT HUMAN POPULATION EXPLOSION

THE NEED FOR GLOBAL BIOETHICS

ISBN: 0-941694-34-8
160 Pages, Illustrated, $15.00
Add $2.00 (U.S.) or $2.50 (Foreign) Post and Handling
MASTERCARD/VISA ORDERS ACCEPTED

Institute for the Study of Man
1133 13th St. NW, Suite C-2
Washington, D.C. 20005
Tel: (202) 371-2700 Fax: (202) 371-1523

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Joyride to Infinity

Robert A. McConnell Ph.D.

Joyride to Infinity is an alarm-sounding book that manages to be at the same time both conservative and radical in its encyclopedic exploration of our future.

The theme is over-population and the resultant evils of mass immigration and environmental pollution. If mankind cannot control its actions, Nature, in her cruelty, will do it for us. The author is a reluctant radical who was forced to acknowledge the extreme findings that he uncovered in his exhaustive pursuit of reality.

Professor McConnell argues that the globalization of our economy is leading to the end of nationhood, mass migration and the uncontrolled growth of population. The causal links are now clear. He sees no hope for sub-Saharan Africa and little hope for China, which faced its population problem too late. The rest of the world is having to cope with the overflow from the regions that are over-reproducing.

Planning for the future requires caring about the future. Those cultures which have no past to preserve will have no future to live in. Cultural Diversity, which begins by denying the past, will never summon the will to sacrifice for the preservation of the Earth as a worthy habitat.

The author is both an engineer and a scientist. As an engineer, his competence was proved as a radar development group leader in World War II. As a scientist with a Ph.D. in physics he is a Research Professor Emeritus of Biological Science, a Life Senior Member of the Institute of Electrical and Electronics Engineers, a Fellow of the American Psychological Society, and a Fellow of the American Association for the Advancement of Science.

ISBN 1-878465-35-X

Paperback, 440 pages, January 2000, Price $25.00

MASTERCARD/VISA ACCEPTED

Scott-Townsend Publishers

P.O. Box 34070, N.W. Washington, D.C. 20043

Tel: (202) 371-2700 Fax: (202) 371-1523 Email: socecon@aol.com

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED